

January 2018

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Executive Summary

- ❖ As of February 10, the Central Election Committee registered 44 candidates for the Presidency. According to the latest electoral polls, the list of top 3 candidates includes (i) comedian and actor Volodymyr Zelenskiy, (ii) former Prime Minister Yulia Tymoshenko, and (iii) President Petro Poroshenko. All major polls suggest that the election will require two rounds, since none of the candidate will be able to get “50%+” votes in the first round.
- ❖ In January, Ukrainian Cabinet of Ministers issued a resolution, which would introduce monetization of communal subsidies for natural gas consumption. It should improve the situation in the sector and stimulate increase in energy efficiency in Ukrainian households. This measure was supported by the new Stand-by arrangement with the IMF.
- ❖ The State Statistics Service reports that the Ukrainian economy accelerated to 3.4% yoy in the fourth quarter of 2018, compared to a growth rate of 2.8% in the third quarter. This acceleration allowed GDP growth to reach about 3.3% yoy for the year as a whole, the best performance since 2012. The main growth driver was agricultural production, which expanded by 7.8% yoy, followed by retail trade (6.1% yoy), and construction (4.4% yoy).
- ❖ The cumulative consolidated fiscal budget deficit for 2018 amounted to UAH 67.8 billion (about 1.9% of GDP), which is below the limit agreed with the IMF.
- ❖ Consumer inflation decelerated to 9.8% yoy in 2018 as compared to 13.7% yoy in 2017. The major reasons for lower inflation were the strict monetary policy of the NBU (which raised the policy rate six times since October 2017), expansion of domestic supply of several foodstuffs, and lower world prices of foodstuffs.
- ❖ Commercial banks increased their portfolio of Hryvnia deposits of the corporate sector as well as of households in December. However, growth of foreign currency deposits slowed down mainly because of the decline in foreign currency corporate deposits. Growth of Hryvnia loans to household remained high at 31.4% yoy.
- ❖ The UAH/USD exchange rate depreciated during the first ten days of January, but appreciated at moderate pace during the last 20 days of January and almost reached the level at which it started the month at 27.8 UAH/USD.
- ❖ During 2018, Ukraine’s current account deficit reached USD 4.7 billion (3.7% of GDP), compared to USD 2.4 billion in 2017. This deficit was fully covered by net financial inflows, with the result that the overall balance of payments generated a surplus of USD 2.9 billion. Ukrainian international reserves increased to USD 20.8 billion, which are enough to cover 3.4 months of imports.

| Main Macroeconomic Indicators | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019f |
|---|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| GDP, USD billion | 180 | 130 | 87 | 93.4 | 113 | 125 | 135 |
| Real GDP Growth, % yoy | 0.0 | -6.6 | -9.9 | 2.4 | 2.5 | 3.3 | 3.0 |
| Fiscal Balance (incl. Naftogaz/Pension Fund), % of GDP | -6.5 | -11.7 | -2.1 | -2.3 | -1.4 | -1.9 | -2.3 |
| Public Debt, External and Domestic, % of GDP | 40.4 | 69.4 | 79.1 | 80.9 | 71.8 | 62.6 | 64.5 |
| Consumer Inflation, eop, % yoy | 0.5 | 24.9 | 43.3 | 12.4 | 13.7 | 9.8 | 8.0 |
| NBU Key Policy Interest Rate, % eop | 6.5 | 14.0 | 22.0 | 14.0 | 14.5 | 18.0 | 16.0 |
| Hryvnia Exchange Rate per USD, eop | 8.2 | 15.8 | 24.0 | 27.1 | 28.1 | 27.7 | 30.0 |
| Current Account Balance, % of GDP | -9.2 | -3.5 | 1.8 | -1.5 | -2.2 | -3.7 | -3.6 |
| Merchandise Exports, USD billions | 59 | 51 | 35 | 34 | 40 | 43 | 46 |
| Merchandise Imports, USD billions | 81 | 58 | 39 | 40 | 49 | 56 | 58 |
| FDI, Net Annual Inflow, USD billion | 4.5 | 0.4 | 3.0 | 3.3 | 2.3 | 2.4 | 2.0 |
| International Reserves, USD billion | 20.4 | 7.5 | 13.3 | 15.5 | 18.8 | 20.8 | 18.0 |
| Public External Debt, USD billion | 31.7 | 34.9 | 42.6 | 42.5 | 47.0 | 49.9 | 50.0 |
| Private External Debt, USD billion | 110.3 | 91.2 | 76.0 | 69.9 | 70.0 | 71.0 | 72.0 |

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Political and Reform Developments

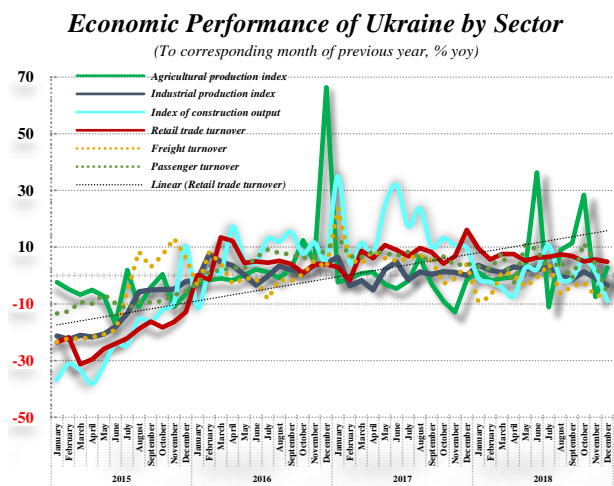
Ukraine’s Presidential election scheduled for March 31 is the central topic of the current political life in the country. As of February 10, the Central Election Committee registered 44 candidates. According to the latest electoral polls the list of top 5 candidates includes (i) comedian and actor Volodymyr Zelenskiy, (ii) former Prime Minister Yulia Tymoshenko, (iii) President Petro Poroshenko, (iv) leader of the political party For Life ex-vice Prime Minister of Ukraine Yuriy Boyko, and (v) ex-minister of defense and Civil Position party leader Anatoly Hrytsenko. All major polls suggest that the election will require two rounds since none of the candidate will be able to get “50%+” votes in the first round. The expected second round will be scheduled for April 21. To ensure democratic, free and fair elections, international observers are already coming to the country. Observation mission from the Organization for Security and Cooperation in Europe has already started monitoring the presidential election process.

In the recently published 2019 World Freedom Index, Ukraine was ranked as “partly free” country. Ukraine scored 60 points out of 100, losing two points compared to its score in 2018. The points were lost because of the increasing number of attacks on political activists and journalists. Freedom House estimates that over 50 activists and human rights defenders were attacked in the first nine months of 2018. Among other negative tendencies in Ukraine, the organization cited the poor track record of many candidates for the newly established anti-corruption court. Freedom House emphasis that “corruption and limits on media freedom have been ongoing problems for Ukraine”.

In January, the Ukrainian Cabinet of Ministers issued a resolution to introduce monetization of communal subsidies for natural gas consumption. It should improve the situation in the sector and stimulate increase in energy efficiency in Ukrainian households. This measure was supported by the new Stand-by arrangement with the IMF.

Economic Growth

The State Statistics Service reports that the Ukrainian economy accelerated to 3.4% yoy in the fourth quarter of 2018, compared to a growth rate of 2.8% in the third quarter. This acceleration allowed GDP growth to reach about 3.3% yoy for the year as a whole, the best performance since 2012. The main growth driver was agricultural production, which expanded by 7.8% yoy as compared to a 2.7% yoy decline in 2017. Growth in retail trade and in construction activities reached 6.1% yoy and 4.4% yoy, respectively. Wholesale trade reported slightly accelerated growth of 3.3% yoy (2.8% yoy in 2017). Industrial production expanded by 1.1% yoy in 2018 as compared to no growth in the previous year.



These positive results in 2018 were supported by favorably developments in nominal and real monthly average wages, which increased by 20.5% yoy 9.7% yoy, respectively and by a strong Hryvnia, and high level of workers’ remittances from abroad.

For 2019, we expect that real GDP growth will slow down to about 3% yoy. Domestic consumption and investments will continue to be the main growth drivers, thanks in part to continued increases in workers remittances and in wages and salaries. But domestic investment will slow down due in part to political uncertainties related to the Presidential and Rada elections. In addition, agricultural production may not be able to maintain the fast pace achieved in 2018.

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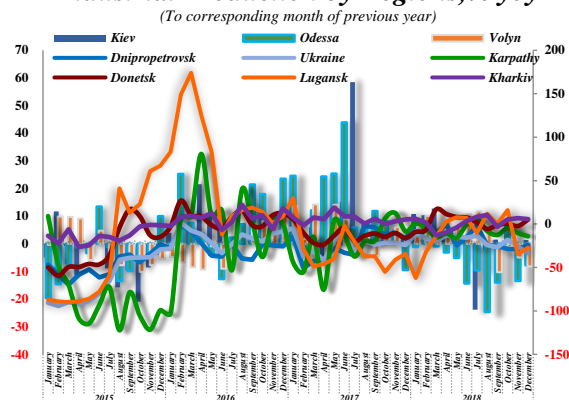
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High-frequency data showed that in December 2018 retail trade turnover (4.9% yoy) and agriculture (2.8% yoy) continued to lead economic growth. However, other sectors' output showed negative results, including industrial production and construction activities whose output declined by -3.5% yoy and by -8.8% yoy, respectively.

Within the industrial sector, in December 2018, the mining subsector performed better, with extraction of crude petroleum and natural gas growing by 5% yoy, and mining of coal and lignite expanding by 11.4% yoy. Electric power generation, transmission and distribution also performed well in December, with a growth rate of 11.4% yoy. On the other hand, during December 2018, manufacturing production deteriorated in almost every subsector. The major declines took place in machinery and equipment output (-16.8% yoy); textiles (-15.9% yoy); basic metals (-9.9% yoy); rubber & plastic products (-7.2% yoy); furniture (-6.2% yoy); foodstuffs (-5.5% yoy); chemicals (-3.3% yoy); wood products, paper and printing (-2.7% yoy); basic pharmaceutical products (-0.2% yoy); and coke & refined petroleum products (-0.1% yoy).

Industrial Production by Regions, % yoy



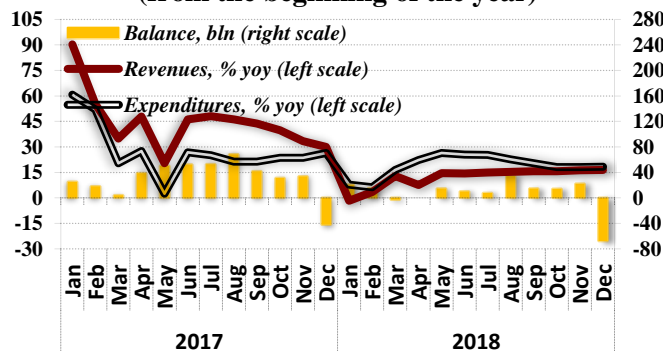
Source: State Statistics Service, the Bleyzer Foundation

The regional composition of Ukraine's industrial output shows that positive rates of growth took place in Kirovohrad oblast (22.9% yoy), Rivne (15.5% yoy), Vinnytsya (11.1% yoy), Cherkasy (7.6% yoy), Kharkiv (5.5% yoy), Donetsk (5.1% yoy), Kherson (2.8% yoy), Zakarpattya (2.7% yoy), Kyiv (1.4% yoy), Ivano-Frankivsk (1.1% yoy), Poltava (0.6% yoy). Other regions showed industrial production deterioration, principally in Ternopil (-37.7% yoy), Luhansk (-27% yoy), Khmelnytskyi (-19.4% yoy), Zhytomyr (-11.8% yoy), Lviv (-10.7% yoy), Chernivtsi (-8.3% yoy), Volyn (-8.2% yoy), Odesa (-7.8% yoy), Mikolayiv (-5.6% yoy), Kyiv city (-5.5% yoy), Sumy (-4.5% yoy), Zaporizhzhya (-1.9% yoy) and Dnipropetrovsk (-0.5% yoy).

Fiscal Policy

In December 2018, the consolidated fiscal budget was executed with a large fiscal deficit. The state budget made the greater contribution to the deficit at UAH 59.1 billion, while the cumulative deficit of local budgets was UAH 30.7 billion. The government financed budget execution through extensive borrowing (net borrowings totalled UAH 43.3 billion) and pumped significant amounts of cash into the economy (UAH 34.3 billion). Also, the government used other instruments regulating liquidity worth UAH 12.2 billion. The cumulative consolidated fiscal budget balance for 2018 was negative at UAH 67.8 billion (about 1.9% of GDP), below the limit agreed with the IMF.

Dynamics of consolidated budget components (from the beginning of the year)



Source: The Ministry of Finance of Ukraine, The Bleyzer Foundation

Growth of consolidated budget revenues slowed a bit in December but remained at a high level. The 18.4% yoy increase was supported by solid expansion of both tax and nontax revenues, although the latter grew much faster (40.5% yoy as compared to 13.3% yoy). Slower growth of tax revenues was the result of lower receipts from most key taxes, especially receipts from taxes on imported goods. This was the result of fast deceleration of imports growth. At the same time, receipts from domestic taxes

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were the major driver of tax revenues' expansion. This happened because of several reasons: return to growth of production of some exisable goods, continued growth of wages, and relatively low VAT reimbursements. As for nontax revenues, they expanded thanks to Naftogaz' transfer of the remaining dividends for 2017 (UAH 7.9 billion). Cumulative consolidated budget revenues grew at 16.5% yoy in 2018.

Traditionally, December consolidated budget expenditures are the highest in the year – 15.8% of total yearly expenditures in December 2018. In year-over-year terms, consolidated budget expenditures expanded at an accelerated pace of 19.4% yoy. This growth was caused by increases in both current and capital expenditures. Current expenditures expanded by 14.5% yoy mainly on the back of spending on goods and services (which grew by 29.0% yoy). Growth of expenditures on state debt servicing decelerated significantly to 17.2% yoy. Only social security spending posted a moderate decline of 1.2% yoy in December. Capital expenditures grew faster at 37.8% yoy thanks to fast growth in both fixed assets acquisition and capital transfers. Growth of the cumulative consolidated budget expenditures totaled 18.3% yoy in 2018.

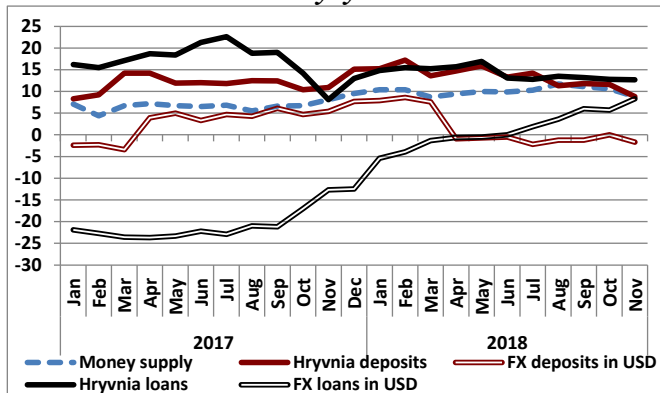
The government and NBU expenditures on principal and servicing payments denominated in foreign currency decreased by almost five times in December as compared to November. USD 158.2 million equivalent was paid to the IMF. Principal and servicing payments on domestic sovereign bonds denominated in foreign currency totaled USD 142.2 million.

Monetary Policy

Inflation. Consumer inflation decelerated to 9.8% yoy in 2018 as compared to 13.7% yoy in 2017. The major reason of lower inflation was strict monetary policy of the NBU (which raised the policy rate six times since October 2017). Expansion of domestic supply of several foodstuffs and lower world prices of foodstuffs served as additional factors of slower inflation. On the other hand, consumer inflation was still above the medium-term target band of 6% ± 2% set by the NBU Basic Monetary Policy Principles for 2018. This was the result of increases in administratively regulated prices and tariffs, higher production cost (mainly due to higher wages), and growth of oil prices during most of the year. Steady growth of consumer demand was also an important driver of inflation in 2018. Core inflation decelerated from 9.5% yoy to 8.7% yoy in 2018.

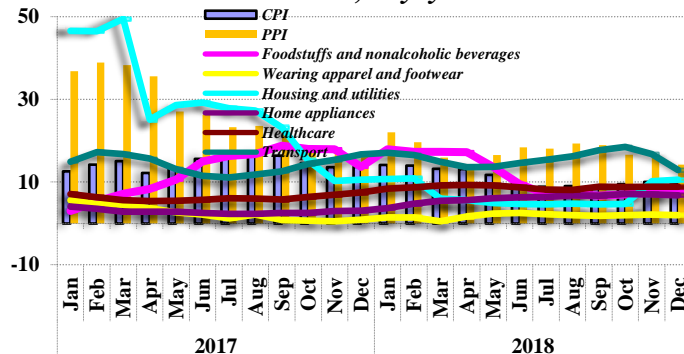
Most of the major groups of goods and services observed little changes in price dynamics in December. Transport services posted the most significant price decline from 16.8% yoy in November to 12.9% yoy in December. Restaurants and hotels were at the second place with a 0.7 percentage point deceleration to 13.0% yoy growth. Communication services saw the most significant acceleration in price growth of 0.6 percentage points to 15.1% yoy. Price growth of alcoholic and tobacco products accelerated from 17.4% yoy to 17.9% yoy.

Dynamics of Money Supply, Deposits, and Loans, % yoy



Source: The NBU, The Bleyzer Foundation

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



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

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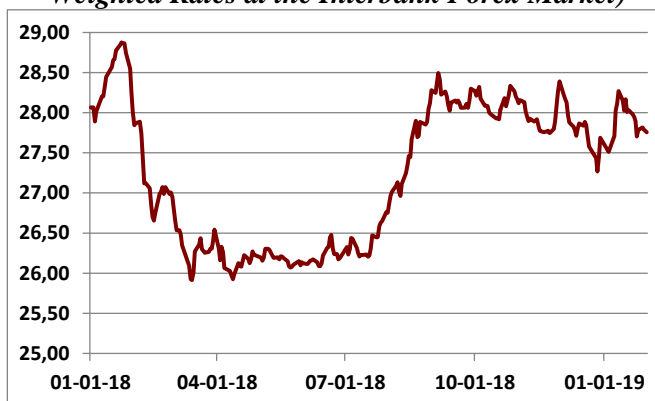
Banking Sector. Commercial banks increased their portfolio of national currency deposits of the corporate sector as well as of households in December. However, growth of deposits in general slowed down in year-over-year terms mainly because of the decline in foreign currency corporate deposits.

Although growth of household hryvnia loans remained high at 31.4% yoy, the overall growth of the national currency loans decelerated to 8.1% yoy in December due to lower corporate loans.

Growth of the monetary base significantly decelerated in December. It dropped 5 percentage points to 9.2% yoy. Slower growth of total deposits denominated in hryvnia led deceleration in growth of money supply from 8.8% yoy registered in November to 5.6% yoy.

Hryvnia Exchange Rate. The UAH/USD exchange rate observed several trend reversals in January. First, it depreciated during the first ten days of the month on the back of increased demand for dollar on the side of non-residents and generally lower business activities in the country. Then, the exchange rate reversed its trend and appreciated until the very end of the month. Lower demand for dollar on the side of non-residents and steady supply on the side of exporters were the major reasons for the appreciation. At the same time, the Ministry of Finance held several auctions of sovereign bonds denominated in Hryvnia leading to increased supply of Dollars also on the side of non-residents. Overall, the exchange rate was appreciating at moderate pace during the last 20 days of January and almost reached the level at which it started the month at 27.8 UAH/USD.

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



Source: The NBU, The Bleyzer Foundation

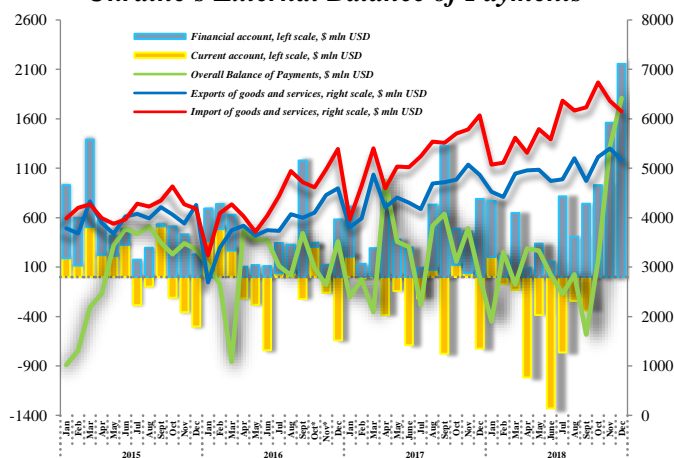
On January 4th, the NBU approved new foreign exchange regulation system and published its roadmap of further foreign exchange liberalization. The system consists of eight Decrees of the NBU substituting the previous base of 56 legal acts of foreign exchange regulation and two technical acts aimed at new system enforcement. The purpose of the new system is deregulation of investment, simplification of trans-border foreign exchange operations, and enhancement of the list of available foreign exchange operations. The new system will come into force on February 7th, 2019 which will lead to lifting of over twenty foreign exchange restrictions.

International Trade and Capital

During 2018, Ukraine's current account deficit reached USD 4.7 billion (3.6% of GDP), compared to USD 2.4 billion in 2017. This large increase in the current account deficit was due to a slower growth of exports of goods and services (9.5% yoy), than imports expansion (by 12.8% yoy).

In January-December 2018, Ukraine's merchandised exports grew by 9.2% yoy to USD 43.3 billion, while imports of goods increased by 14% yoy to USD 56.3

Ukraine's External Balance of Payments



Source: NBU, the Bleyzer Foundation

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billion. During the year, exports of agricultural products rose by 4.8% yoy to USD 18.6 billion and continued to be the largest merchandise exports, accounting for 42.9% share of the total export amount. Other sectors also performed well with the following growth rates: timber & wood products (19.4% yoy), chemicals (16% yoy), metals (15.3% yoy), industrial goods (13% yoy), mineral products (10.4% yoy), and informal trade products (4.5% yoy). In January-December 2018, merchandised imports increased at a faster pace, particularly industrial goods (21% yoy), metals (19.3% yoy), machinery & equipment (17.8% yoy), agricultural products (17.6% yoy), timber & wood products (15% yoy), minerals (14.3% yoy), chemicals goods (8.9% yoy) & informal trade (0.7% yoy).

In terms of regional orientation of Ukrainian merchandised trade, the largest deficit from trade took place with the Russian Federation, with the trade deficit growing by 31% yoy to USD 4.9 billion in 2018. During the year, Ukraine's exports to the Russian Federation declined by -9.9% yoy to USD 3.1 billion, while imports increased by 11.7% yoy to USD 8.0 billion. By contrast, Ukraine's good export to Europe increased by 16.1% yoy to USD 16.7 billion while Ukraine's imports raised by 11.4% yoy to USD 22.7 billion. Similar results took place in trade with Asia.

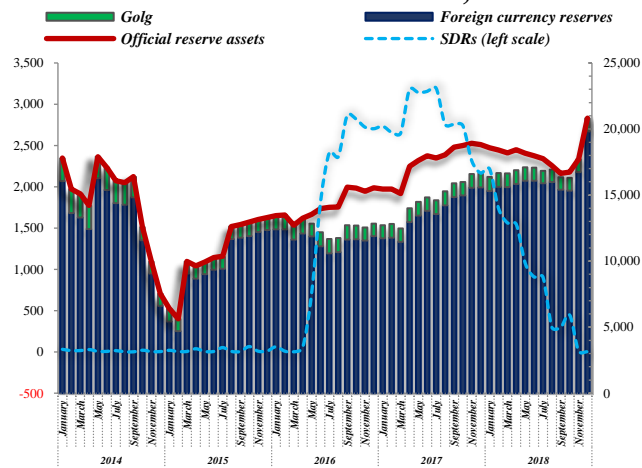
Other countries also continued to grow their merchandised trade with Ukraine, with exports to America increasing by 37.4% yoy (3.6% share), to the USA by 33.7% yoy (2.5% share), to Africa by 0.1% yoy (9.3% share) and to Australia by 80.7% yoy (0.1% share). Ukrainian merchandise imports from other countries also showed expansion, as follows: from America by 14.4 yoy (6.7% share), from the USA by 17.4% yoy (5% share), from Asia by 19.4% yoy (20.1% share), from Europe 23.7% yoy (40.9 % share) and from Africa by 1.6% yoy (1% share).

During the year of 2018, Ukraine's current account deficit of USD 4.7 billion was fully covered by net inflows from the financial account, which grew by 49.5% yoy to USD 7.5 billion (of which USD 2.2 billion took place in December 2018), compared with USD 5.0 billion in 2017. These financial inflows resulted mainly from Ukrainian public sector inflow transactions which increased by 32.5% yoy to USD 2.8 billion, as well as private sector inflow which increased by 0.7% yoy to USD 2.9 billion. The largest support from the public sector to the financial account inflows came from foreign state bonds (USD 2 billion inflow), as well as from external credits from the World Bank and EU (USD 1 billion) during December. Meanwhile the private sector showed an inflow growth of 19.3% yoy to USD 2.9 billion in 2018.

In 2018, foreign direct investments declined by 8.9% yoy to USD 2.4 billion, despite of the fact that during the last month they grew by 34.8% yoy to USD 329 million. The real sector received USD 1.4 billion of these FDI, or 58% from the total amount in 2018. In 2018, net portfolio investments grew by 13.7% to USD 2.0 billion, compared to USD 1.8 billion in 2017.

As a result of these financial inflows, the consolidated balance of payments generated a surplus of USD 2.9 billion. Ukrainian international reserves increased to USD 20.8 billion, enough to cover 3.4 months of imports.

Ukraine's International Reserves, mln USD



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