

February 2018

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### *Executive Summary*

- ❖ The US and other international partners of Ukraine are taking more concrete measures to support Ukraine's security and territorial integrity. A key US decision was to supply Ukraine with Javelin anti-tank weapon systems. Some European countries have also said that they may also provide lethal defensive weapons to Ukraine once the US starts delivering Javelins.
- ❖ Ukraine continues to implement its reform agenda although at a slow pace. Currently, the legislation on the establishment of the Anti-Corruption Court was passed by Verhovna Rada in the first reading. It is expected that the pertinent committee of the Rada will introduce changes required by the EU, IMF and Venice Commission.
- ❖ The IMF has stated that, in addition to satisfactory legislation on the Anticorruption Court, the fifth tranche release (probably about USD 1.5 billion) will depend on further progress on pension reform, energy/gas sector policies, the adequacy of the 2018 fiscal budget, and a revised privatization law.
- ❖ Monthly data for January 2018 show that the economy is stabilizing, although with uneven economic performances. Good economic performance was experienced in retail trade turnover, with a growth rate of 9.6% yoy. The industrial sector also showed good performance in January, with a growth rate of 3.6% yoy, the stronger growth rate in seven months. Similarly, the agricultural sector had a 1.1% yoy increase in output, in contrast to the negative signs of the previous four months. Ukraine passenger turnover also performed well in January, increasing by 3.2% yoy. On the other hand, in part due to bad weather, freight transportation turnover declined by -9.3% yoy, and construction output dropped by 1% yoy.
- ❖ The consolidated fiscal budget (state and local) for January 2018 had a surplus equivalent to 8.3% of period GDP.
- ❖ Consumer inflation in January reached 14.1% yoy, 0.4 percentage points higher than in December (13.7% yoy).
- ❖ In the banking sector, in January 2018 growth of corporate deposits remained significant at 10.2% yoy, while growth of household deposits remained almost unchanged at 19.4% yoy. Lending activities of commercial banks remained weak.
- ❖ The UAH/USD exchange rate appreciated by around 3.7% in February ending the month at around 26.8 UAH/USD.
- ❖ In January 2018, the current account of the balance of payments had a small deficit of USD 61 million, compared to a surplus of USD 131 million in January 2017. The financial account also had outflows amounting to USD 388 million in January, due to repayments of corporate debt (USD 230 million) and trade credits (USD 204 million). As a result, international reserves declined by USD 449 million to USD 18.6 billion (3.5 months of imports).

<b>Main Macroeconomic Indicators</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017e</b>	<b>2018f</b>
<b>GDP, USD billion</b>	173	180	130	87	93.4	104	110
<b>Real GDP Growth, % yoy</b>	0.2	0.0	-6.6	-9.9	2.3	2.2	3.0
<b>Fiscal Balance (incl. Naftogaz/Pension Fund), % of GDP</b>	-5.5	-6.5	-11.7	-2.1	-2.3	-1.5	-2.5
<b>Public Debt, External and Domestic, % of GDP</b>	36.6	40.4	69.4	79.1	81.2	78.5	78.0
<b>Consumer Inflation, eop, % yoy</b>	-0.2	0.5	24.9	43.3	12.4	13.7	9.0
<b>Hryvnia Exchange Rate per USD, eop</b>	8.1	8.2	15.8	24.0	27.1	28.1	29.0
<b>Current Account Balance, % of GDP</b>	-8.3	-9.2	-3.5	-0.2	-3.8	-3.7	-3.5
<b>FDI, Net Annual Inflow, USD billion</b>	8.4	4.5	0.4	3.0	3.3	2.3	5.0
<b>International Reserves, USD billion</b>	24.5	20.4	7.5	13.3	15.5	18.8	21.0
<b>Public External Debt, USD billion</b>	32.1	31.7	34.9	42.6	42.5	47.0	52.0
<b>Private External Debt, USD billion</b>	102.3	110.3	91.2	76.0	69.9	67.0	72.0

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### ***Political and Reform Developments***

The US and other international partners of Ukraine are taking more concrete measures to support Ukraine's security and territorial integrity. A key US decision was to supply Ukraine with Javelin anti-tank weapon systems. Some European countries have also said that they may also provide lethal defensive weapons to Ukraine once the US starts delivering Javelins. The United States has also initiated a number of investigations against top level Russian government officials and continue to expand sanctions against Moscow. The possibility of introduction the UN peacekeepers in the conflict zone of Ukraine is under discussion by the Ukrainian Ministry for Foreign Affairs with its counterparts from the Normandy Format countries. According to the statements of the Minister Klimkin, a follow up meeting will be scheduled shortly.

Despite serious international efforts to resolve the military conflict in Eastern Ukraine, Russian-backed separatists continue their attacks. According to Ukrainian intelligence services, the number of Russian militants located in the conflict zone sums from 3,000 to 16,000 depending on the intensity of military actions. Ukrainian military corps is constantly under artillery attacks although currently their numbers have decreased substantially. It might signal either a temporarily withdrawal of some portions of Russian troops or their rotation in the Donetsk region.

Ukraine continues to implement its reform agenda although at a slow pace. Currently the main efforts are concentrated in fighting corruption and reforming the country's health care system. In particular, in February the office of Anti-corruption Prosecutor reported its readiness to send to court several cases against top level government officials accused in corruption. However, slow progress with implementation of the Anticorruption Court does not allow accelerating the process. Currently, the legislation on the establishment of the Anti-Corruption Court was passed by Verhovna Rada in the first reading. It is expected that the pertinent committee of the Rada will introduces changes required by the EU, IMF and Venice Commission, although there may still be outstanding issues to be further discussed with the international agencies. In particular, the government is still resisting the recommendation to give international legal advisors a stronger role beyond "voice" in the selection of judges for the Anti-corruption Court. According to the IMF, as is, the draft law is not "conducive" to the court's independence and "transparent appointment of competent and trustworthy anti-corruption judges". On Health System reform, the Ukrainian Ministry of Health reports that there were several billion hryvnas of savings on public procurement since the beginning of the year. Such savings became possible due to the transfer of this function to international organizations, including the World Health Organization.

The IMF has stated that, in addition to satisfactory legislation on the Anticorruption Court, the fifth tranche release (probably about USD 1.5 billion) will depend on further progress on pension reform, energy/gas sector policies, the adequacy of the 2018 fiscal budget, and a revised privatization law. While some progress has been made, many actions are still pending. In any event, the continuation of lending by the IMF and other international agencies is essential, as Ukraine will need to repay and serve external government debt of about USD 6 billion in 2018.

### ***Economic***

Following the economic crises of 2014/15, caused by Russia's invasion of Ukraine, the economy has now stabilized, although at a low base and with growth decelerating in the last quarter of last year. GDP grew by 1.8% yoy in October-December 2017, and by 2.2% in the entire year 2017.

Monthly data for January 2018 show uneven economic performances. Good economic performance was experienced in retail trade turnover, with a growth rate of 9.6% yoy, although lower than in the previous month. The industrial sector also showed good performance in January, with a growth rate of 3.6% yoy, the

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stronger growth rate in seven months. Similarly, the agricultural sector had a 1.1% yoy increase in output, in contrast to the negative signs of the previous four months (-3% yoy, -9% yoy, -13% yoy, and -1.5% yoy in September-December respectively). In the same way, Ukraine passenger turnover also performed well in January, increasing by 3.2% yoy.

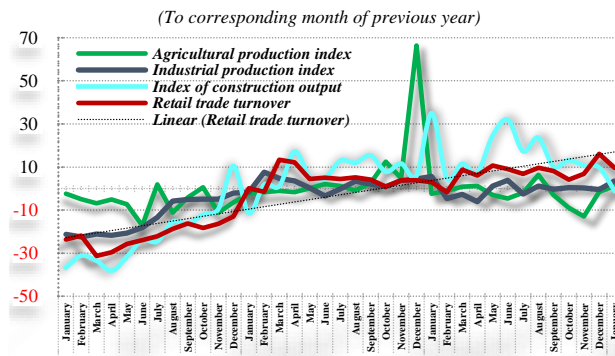
On the other hand, in January 2018, in part due to bad weather, freight transportation turnover declined by -9.3% yoy, and construction output dropped by 1% yoy.

Within the industrial sector, in January 2018 manufacturing activities performed very well with a growth rate of 9.7% yoy. On the other hand, mining and quarrying had a drop of 0.1% yoy, and electricity, gas, steam, air conditioning supply declined by 8.1% yoy. The best manufacturing performance in January took place in chemicals (56% yoy); machinery and equipment (22.1% yoy); wood products (14.7% yoy), pharmaceuticals (9% yoy), metallurgy (8% yoy), furniture (7% yoy); foodstuffs (3% yoy); and plastics (2.5% yoy). Two manufacturing subsectors had negative rates of growth, textiles (-0.8% yoy) and production of coke and refined petroleum products (-5.7% yoy).

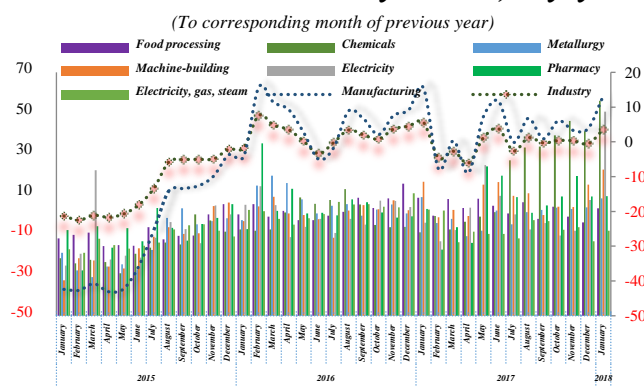
On a regional basis, most oblasts enjoyed positive rates of industrial growth in January 2018, with the highest growth rates at the following regions: Lviv (18.1% yoy), Mikolayiv (16.5% yoy), Chernivtsi (16.1% yoy), Ivano-Frankivsk (15.2% yoy), Kyiv (10.8% yoy), Zaporizhzhya (10.2% yoy), Kirovohrad (9.6% yoy), Dnipropetrovsk (7.4% yoy), Zakarpattya (7.4% yoy), Ternopil (6.5% yoy), Rivne (6.3% yoy), Kharkiv (6% yoy), Volyn (5% yoy), Zhytomyr (3.2% yoy), Sumy (2.3% yoy), Vinnytsya (1.9% yoy), Kherson (1.2% yoy), and Chernihiv (0.3% yoy). On the other hand, in January 2018, five oblasts experienced negative growth rates: Luhansk (-62% yoy); Donetsk (-9.1% yoy); Khmelnytskyi (-5.3% yoy); Kyiv city (-3.4% yoy); Odesa (-1.1% yoy).

As a consequence of better economic performance, Ukraine had reasonable increase of real wages (12.3% yoy) and nominal wages (28.4% yoy). In the same way, the overall number of registered unemployed people fell down (by -11.7% yoy), in January 2018.

### Ukraine Economic Performance by Sector, % yoy

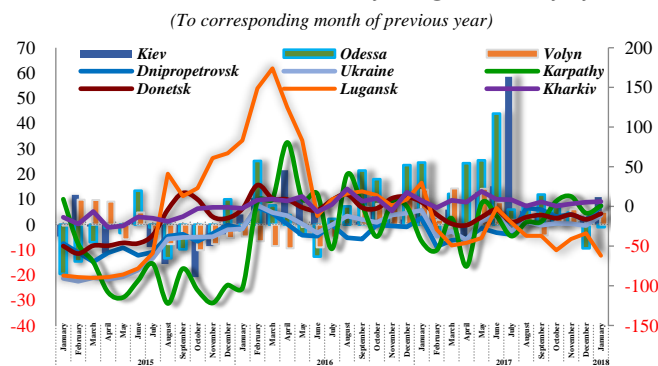


### Industrial Production by Sectors, % yoy



Source: State Statistics Committee, The Bleyzer Foundation

### Industrial Production by Regions, % yoy



Source: State Statistics Committee, The Bleyzer Foundation

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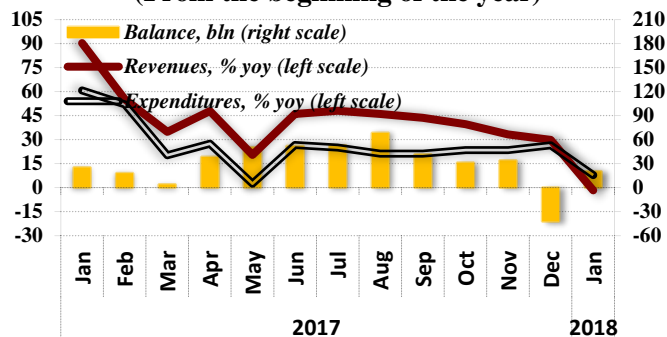
### Fiscal Policy

In January 2018, fiscal revenues exceeded fiscal expenditures at both state and local levels. The state budget was executed with a surplus of UAH 7.8 billion which, was lower than a year ago due to declines in revenues and moderate increase in expenditures. Local budgets showed a surplus of UAH 12.6 billion which was larger than a year ago. This was the result of faster growth in revenues as compared to that of expenditures. The consolidated budget surplus totaled UAH 20.5 billion (or about 8.3% of period GDP).

State budget revenues declined by 7.2% yoy in January. The major reason of the decline was a contraction of tax revenues by 9.7% yoy because of lower VAT receipts. Receipts from most of other taxes expanded at a fast pace (personal income tax, 28.6% yoy; corporate profit tax, 251.2% yoy; and excise tax, 20.2% yoy). Nontax revenues increased by 34.1% yoy. Cumulative consolidated budget revenues (state and local) declined by 1.7% yoy in January.

State budget expenditures expanded in January. A 9.3% yoy growth was driven mainly by moderate increases in current transfers (0.9% yoy) and in expenditures on debt servicing (2.0% yoy). At the same time, there were significant increases in payroll expenditures and expenditures on goods and services. Under the functional classification, expenditures on general public administration functions continue to be the largest item, while expenditures on public order, security and judiciary were the second largest in terms of size but posted the largest growth of 41.8% yoy. Cumulative consolidated budget expenditures grew by 7.8% yoy in January.

**Dynamics of consolidated budget components (From the beginning of the year)**



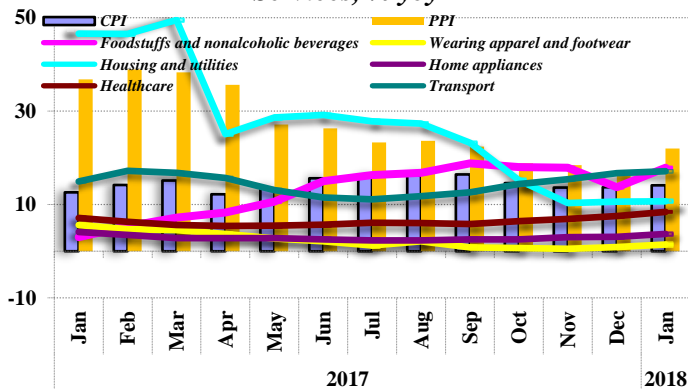
Source: The Ministry of Finance of Ukraine, The Bleyzer Foundation

### Monetary Policy

**Inflation.** Consumer inflation slightly accelerated in January 2018 as compared to December 2017. The all items index inched up by 0.4 percentage points to 14.1% yoy. This level is above the trajectory forecasted by the NBU because of faster growth of prices on food, services, and fuels. Core inflation also accelerated reaching 9.8% yoy which was in line with expectations.

All the major groups of goods and services except for alcoholic and tobacco products and restaurants and hotels saw acceleration in growth of prices in January. Housing and utilities saw the smallest acceleration of 0.1 percentage points to 10.7% yoy, while communication services saw the largest acceleration of 2.6 percentage points to 11.7% yoy. The price growth of the rest of groups of goods and services accelerated within a range of 0.2-0.9 percentage points. Alcoholic and tobacco products still reported the largest price growth of 20.6% yoy which remained almost flat as compared to December 2017. Consumer inflation is expected not to exceed 10% yoy in 2018.

**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.

National currency deposits followed their seasonal trends and declined in both household and corporate sectors in January as compared to December 2017. However, in year-over-year terms, the situation was different. Growth of corporate deposits remained significant at 10.2% yoy, while growth of household deposits remained almost unchanged at 19.4% yoy.

Lending activities of commercial banks remained rather weak in January. Declines in national currency loans to the corporate sector - due to seasonal declines in business activities - almost fully offset growth of household national currency loans. Growth of foreign currency loans denominated in USD was the result of methodological changes. In particular, there were some changes in the accounting to continue its transfer International Accounting Standards.

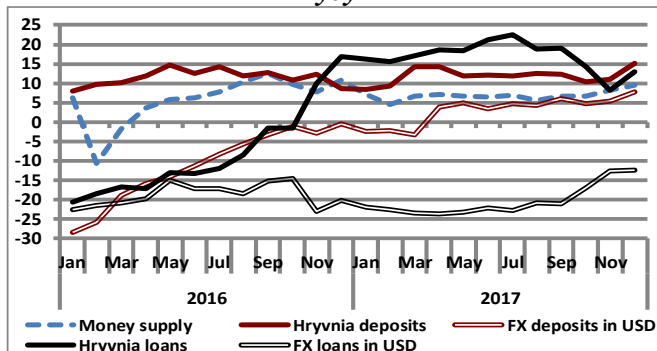
Seasonal decreases in cash resources led to a monthly contraction of 1.7% of the monetary base. At the same time, the year-over-year growth of the monetary base accelerated to 8.4%. Money supply experienced similar changes, decreasing in monthly terms by 2.7% mom, but its year-over-year growth accelerated to 10.4% yoy.

**Hryvnia Exchange Rate.** The UAH/USD exchange rate appreciated by around 3.7% in February. The major reason was a shift of investors' interest from the interbank forex market to sovereign bond market thanks to higher bond yields, which were a direct result of the increase in the policy rate by 1.5 percentage points to 16%. In particular, the Ministry of Finance reported that the state budget received UAH 8.9 billion from placement of domestic sovereign bonds during the month. Therefore, there was high demand for Hryvnias on the side of investors. This and favorable conditions for Ukrainian exporters at the international markets led to increased supply of dollar at the interbank forex market. In addition, the NBU made placements of its certificates of deposit to freeze large inflows of Hryvnias into the banking sector (mainly from the VAT reimbursements). As a result, the UAH/USD exchange rate appreciated from around 27.84 UAH/USD to around 26.8 UAH/USD by the end of February.

### International Trade and Capital

According to the NBU, in January 2018, the current account of the balance of payments had a small deficit of USD 61 million, compared to a surplus of USD 131 million in January 2017. The current account deficit was due to a lower growth in exports of goods and services (19% yoy to USD 4.5 billion), than in imports, which increased by 27% yoy (to USD 4.9 billion). The deficit in goods trade was also the result of higher merchandise import (by 30.5% yoy to USD 3,950 million), than export of goods (22.4% yoy to USD 3,403 million).

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



Source: The NBU, The Bleyzer Foundation

*Dynamics of the Average Weighted UAH/USD Exchange Rate in the Interbank Forex Market*



Source: The NBU, The Bleyzer Foundation

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Ukrainian exports are currently dominated by agricultural exports, which account for 41.5% of total exports (with a January growth rate of 4.2% yoy). Metallurgical exports grew by 35.6% yoy in January and now account for 29% of exports. Mineral exports grew by 29.1% yoy in January, and its share is now 9.3% of the total. Exports of machinery & equipment grew by 41.9 % yoy in January and now represent 6.3% of total exports. On the other hand, chemical exports declined by 54.3% yoy in January and now account for only 4.5% of exports.

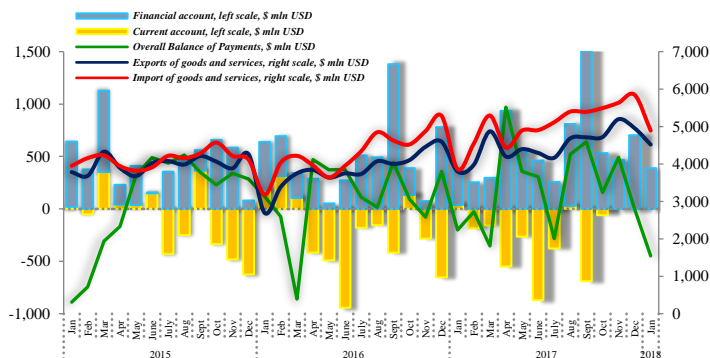
From a geographical point of view, January Ukraine exports to Russia amounted to USD 209 million and fell by -1.4% yoy. They now represent 6.1% of total exports, compared to 7.6% in January 2017. Exports to Asia increased by 12.3% yoy, representing 32.2% of the total Ukrainian exports. Exports to Europe increased by 44.3% yoy and now account for 42.1% of exports (compared to 35.7%, in January 2017).

With regard to merchandise imports, in January mineral products accounted for the major share (25.3% of the total import amount), particularly energy imports, which increased by 16.5% yoy. The second largest product category was machinery and equipment, which accounted for 24.7% of total imports, climbing by 32% yoy in January. Imports of chemical products are the third largest import category but declined by 45.8% yoy in January and now represent 21.2% of total imports. Food imports represent the fourth largest import group (with 9.9% of the total) and increased by 39% yoy in January. Geographically, Europe is the largest supplier of goods to Ukraine, with a 36.9% share; followed by Asia with a 21.5% share. The share of Russia in Ukrainian imports has been increasing to 17.6% of the total (to USD 694 million), compared to 17.3% (USD 522 million) in January 2017.

In January 2018, the financial account showed net outflows of USD 388 million, compared to outflows of USD 334 million in January 2017. The major outflow were due to repayment of corporate long-term loans (USD 230 million), and trade credits (USD 204 million) in January 2018. At the same time, foreign direct investments net inflows reached only USD 80 million.

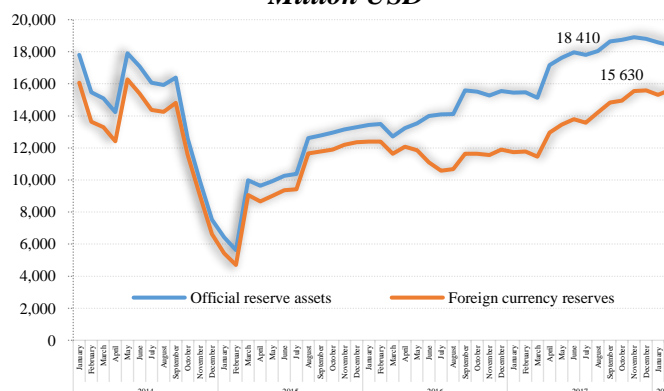
Consequently, the deficit in the current and financial accounts amounted to USD 449 million in January 2018, lowering international reserves to USD 18.6 billion (3.5 months of imports.)

### Ukraine's External Balance of Payments, mln USD



Source: NBU, The Bleyzer Foundation

### Dynamic of Ukraine International Reserves, Million USD



Source: the NBU, the Bleyzer Foundation

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