Ukraine Macroeconomic Situation

December 2019

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

Executive Summary

- On December 9, the leaders of France, Germany, Ukraine, and Russia gathered in Paris to resume negotiations to resolve the conflict in Donbas. The meeting yielded only modest successes: there were agreements on a complete prisoner exchanges by the end of the year, and on the implementation of a permanent ceasefire.
- On December 7th, the IMF announced that a staff level agreement with Ukraine had been reached on the Extended Fund Facility program. The Facility will amount to USD 5.5 billion and will be provided to the country during a 3-year time period. Prior Board conditions include ensuring that Privatbank and other nationalized banks will not be returned to the previous owners.
- Real GDP growth in the 3rd quarter of 2019 reached 4.2% yoy, a rate much higher than expected. Current economic growth was driven by domestic demand for household consumption, with retail trade growing by 11.3% yoy and output construction by 20.8% yoy. Both were supported the higher real and nominal wages.
- The consolidated fiscal budget was in deficit in October. The cumulative consolidated budget balance from the beginning of the year turned negative at UAH 0.7 billion in January-October.
- Consumer inflation continued to decelerate in October, with the overall inflation index dropping 1.0 percentage points to 6.5% yoy, supported by the revaluations of the Hryvnia.
- In the banking sector, Hryvnia deposits posted a good performance in October. National currency deposits grew by 13.1% yoy. However, bank lending activities was sluggish in October. Both hryvnia loans and foreign exchange loans denominated in USD saw little changes in growth dynamics.
- In November, the UAH/USD exchange rate appreciated during the month. Appreciation resulted from increased inflow of dollar from non-residents (who continued purchasing sovereign bonds denominated in Hryvnias) and from exporters, mainly agricultural and metallurgical producers.
- In October 2019, the deficit of Ukraine's current account declined by 8.4% yoy to USD 651 million. The deficit was partly covered by USD 503 million of financial inflows (principally FDI of USD 332 million). The overall balance of payments had a deficit of USD 146 million, declining international reserves to USD 21.9 billion.

Main Macroeconomic Indicators	2013	2014	2015	2016	2017	2018	2019f
GDP, *USD billion*	180	130	87	93.4	113	131	150
Real GDP Growth, *% yoy*	0.0	-6.6	-9.9	2.4	2.5	3.3	3.5
Fiscal Balance *(incl. Naftogaz/Pension Fund),% of*	-6.5	-11.7	-2.1	-2.3	-1.4	-1.9	-2.1
Public Debt, External and Domestic, *% of GDP*	40.4	69.4	79.1	80.9	71.8	60.9	58.0
Consumer Inflation, *eop, % yoy*	0.5	24.9	43.3	12.4	13.7	9.8	7.0
NBU Key Policy Interest Rate, *% eop*	6.5	14.0	22.0	14.0	14.5	18.0	13.5
Hryvnia Exchange Rate per USD, *eop*	8.2	15.8	24.0	27.1	28.1	27.7	26.0
Current Account Balance, *% of GDP*	-9.2	-3.5	1.8	-1.5	-2.2	-3.3	-3.0
Merchandise Exports, *USD billons*	59	51	35	34	40	43	46
Merchandise Imports, *USD billions*	81	58	39	40	49	56	59
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	22.0
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

Where Opportunities Emerge.

Translator: Ieliena Segura
Editor: Rina Bleyzer O'Malley

December 2019

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

Political and Reform Developments

On December 9, the leaders of France, Germany, Ukraine, and Russia gathered in Paris to resume negotiations to resolve the conflict in Donbas. The meeting yielded only modest successes: there were agreements on a complete prisoner exchanges by the end of the year, on the implementation of a permanent ceasefire by the end of the year, and on additional disengagement zones. The effective implementation of these agreements would improve living conditions in the borders areas. But the Paris meeting failed to resolve more fundamental issues. President Putin did not show any flexibility by stressing: (i) the necessity to follow the Minsk agreements to the letter, including the return of the border to Ukraine only after local elections; and (ii) Moscow's insistence on constitutional changes that would provide permanent "special status" to the occupied territories that could weaken the centralized power of the Ukrainian state. On the other hand, President Zelenskyy did not agree to cross any of the red lines set by Ukraine before the meeting: no changes to the Ukrainian constitution, no federalization of the Ukraine state, no elections before withdrawal of foreign troops and return of the Ukrainian border to Kyiv's control. The next summit would be hold in four months without any preconditions. It is expected that the next stage could be a modest improvement in trading with the occupied territories.

On December 7th, prior to the Normandy meeting, the IMF announced that a staff level agreement with Ukraine has been reached on the Extended Fund Facility program. The Facility will amount to USD 5.5 billion will be provided to the country during a 3-year time period. The program should substantially improve Ukrainian external positions, decrease borrowing costs and unblock around USD 0.5 billion of macroeconomic support from EU. However, before IMF Board approval, Ukraine must meet a number of prior actions. The key action relates to ensuring that Privatbank and other nationalized banks will not be returned to the previous owners, and that Ukraine will recover from them the cost of bank resolutions.

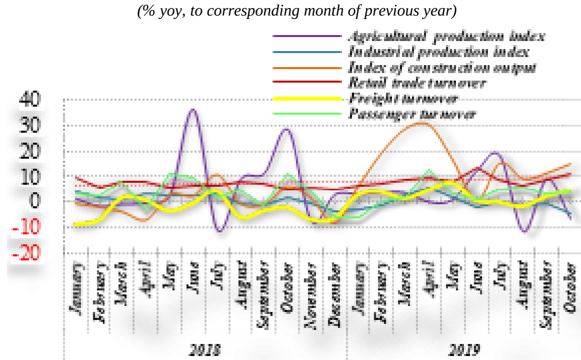
Verhovna Rada put significant efforts into delivering the reform agenda. On anticorruption efforts, MPs voted in a final reading (i) the abolishing of immunity for parliamentarians, (ii) improving capacity of the anticorruption institutions including the State Investigation Service. On increasing competition and de-monopolization of the economy. Verhovna Rada voted for (i) unbundling of Naftogas and (ii) privatization of Ukrspirit.

Economic Growth

According to the latest information from the State Statistic Service of Ukraine, real GDP growth in the 3rd quarter of 2019 reached 4.2% yoy, a rate lower than the 4.6% yoy of the previously 2nd quarter of 2019, but much higher than expected. Current economic growth was driven by domestic demand for household consumption, with retail trade growing by 11.3% yoy and output construction by 20.8% yoy. Both were supported the expansion of real and nominal wages (9.5% yoy and 19% yoy, respectively) in January-October 2019.

Ukraine Economic Performance by Sector

(% yoy, to corresponding month of previous year)



Source: The Bleyzer Foundation

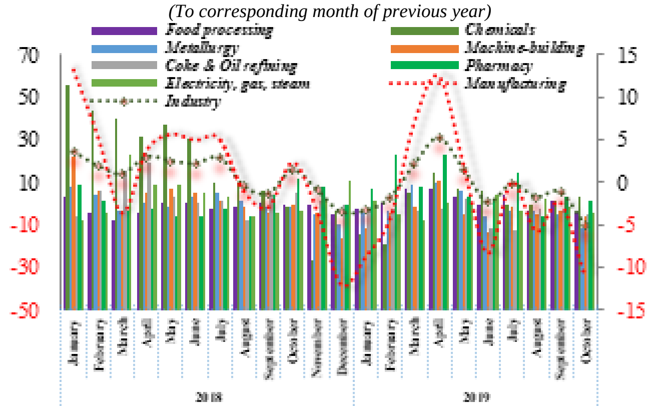
The monthly data released by the State Statistics Service shown that the economy slowed-down during October, due to declines in agricultural output (with a decline of 6.7% yoy) and lower industrial production by 5% yoy. On the other hand, construction output grew by 14.9% yoy, cargo transportation by 4.3% yoy, passenger transportation by 3.9% yoy. Similarly, retail trade turnover increased by 11% yoy. In October, these positive changes were also supported by the real (9.2% yoy) and nominal (16.4% yoy) wages increase, comparing to the same month of the previous year.

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

On the production side of the economy, industrial output showed a reduction of 5% yoy in October 2019, following the decline of 0.6% yoy experienced in January-October 2019. The slowdown in October was also affected by mining and quarrying output declines (2.6% yoy), with metal ores dropping by 4% yoy, extraction of crude petroleum and natural gas declining by 2% yoy, and mining of a coal/lignite shrinking by 2.3% yoy.

Within the industrial sector, manufacturing output declined by 6% yoy in October 2019. Only pharmaceuticals (1.3% yoy) and chemicals (3.5% yoy) showed positive growth of 1.3% and 3,5%, respectively. Other sectors showed negative performance, as follows: basic metals and fabricated metal products (-11.9% yoy); textiles (-9% yoy); rubber and plastic products (-6.4% yoy); machinery and equipment (-5.8% yoy); wood products, paper and printing (-5.4% yoy); coke and refined petroleum products (-5.1% yoy); and foodstuffs, beverages and tobacco products (-4.3% yoy). In addition, Ukrainian electricity, gas, steam and air conditioning supply declined by 4.4% yoy, compared to October of 2018.

Ukraine Industrial Production by Sectors % yoy



Source: The Bleyzer Foundation

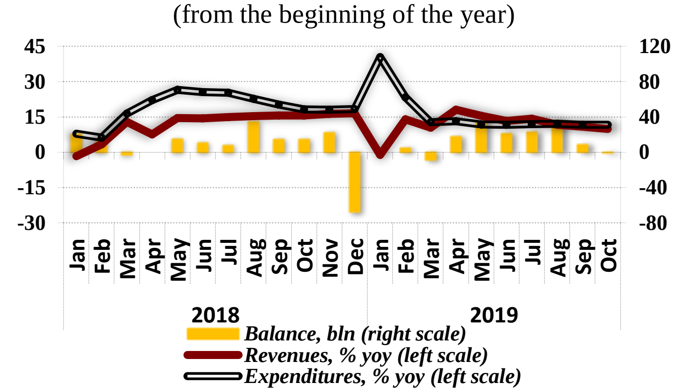
As to the regional distribution of industrial production, the higher rates of growth were experienced in Odesa (12.7% yoy), Zhytomyr (8.9% yoy), Vinnytsya (8.6% yoy), Kirovohrad (1.8% yoy), Chernivtsi (1.7% yoy), Kyiv (1.3% yoy), Zaporizhzhya (1% yoy) and Donetsk (0.6% yoy).

On the other hand, in October 2019, negative growth in industrial production were shown in Zakarpattya (-26% yoy), Chernihiv (-21% yoy), Mikolayiv (-21% yoy), Khmelnytskiy (-20% yoy), Luhansk (-19% yoy), Sumy (-17% yoy), Volyn (-13% yoy), Rivne (-11% yoy), Kharkiv (-10% yoy), Ternopil (-9% yoy), Kyiv city (-8% yoy), Ivano-Frankivsk (-7% yoy), Dnipropetrovsk (-7% yoy), Poltava (-5% yoy), Kherson (-5% yoy), Cherkasy (-5% yoy) and Lviv (-4% yoy).

Fiscal Policy

The consolidated fiscal budget was in deficit in October. The surplus of local budgets at UAH 0.2 billion was too small to offset the UAH 9.6 billion deficit of the central state budget. The government borrowed much less in the process of budget execution in October as compared to previous months. Furthermore, it repaid more than it borrowed. Net repayments totaled UAH 5.5 billion. At the same time, the government pumped UAH 14.9 billion into the economy which more than offset the positive effect from repayments. The cumulative consolidated budget balance from the beginning of the year turned negative at UAH 0.7 billion in January-October.

Consolidated Fiscal Budget Components
(from the beginning of the year)



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

On the revenue side, consolidated budget revenues grew at decelerated pace in October. Total revenues edged up by 1.7% yoy (2.0 percentage points less than in September) thanks to growth in non-tax expenditures of 8.2% yoy and 0.5% yoy growth in tax revenues. Deceleration in growth was the result of curtailing production of tobacco products, larger VAT reimbursements, and slow growth of imports which led to decline in domestic taxes on goods and services of 7.7% yoy through lower receipts from excise taxes and the VAT on both imported and domestically produced goods. Growth rates of both personal income taxes and especially corporate profit taxes were high in October (16.3% yoy and 69.8% yoy respectively). However, this was not enough to compensate for the effect from the above mentioned decline in receipts from domestic taxes on goods and services. Growth of cumulative consolidated budget revenues from the beginning of the year slowed again reaching 9.9% yoy in January-October.

On the fiscal expenditures side, growth of consolidated budget expenditures accelerated in October on the back of higher current expenditures, the effect from accelerated growth of which more than offset the effect from deceleration in growth of capital expenditures. Current expenditures expanded by 12.0% yoy, while capital expenditures grew by 6.7% yoy. Current transfers and debt servicing expenditures were the main drivers of faster growth of current expenditures expanding by 43.3% yoy (15.3% yoy in September) and 22.2% yoy (1.2% yoy decline in September) respectively. Payroll and social security expenditures posted decelerated growth of 17.5% yoy and 11.7% yoy in the reporting month, while expenditures on goods and services declined by 3.3% yoy. Growth of the cumulative consolidated budget expenditures from the beginning of the year remained unchanged at 11.6% yoy in January-October.

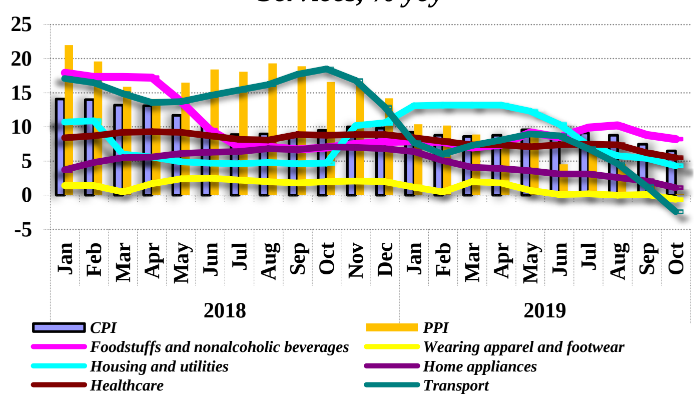
The government made payments on state and guaranteed debt denominated in foreign currency totaling USD 632.3 million equivalent. USD 475.5 million was paid in principal and servicing payments on domestic sovereign bonds denominated in foreign currency. Payments on Eurobonds totaled USD 78.0 million and the rest was spent on liabilities to other foreign creditors and IFIs. Those spendings were partially offset by financial assistance received by the government from international partners (mainly EuroCommission) worth EUR 262.1 million.

Monetary Policy

Inflation. Consumer inflation further decelerated in October. The all items index went down by one percentage point to 6.5% yoy on the back of Hryvnia revaluations. Core inflation decelerated to 5.8% yoy.

Almost all the major groups of goods and services experienced deceleration in price growth, while transport prices and prices of wearing apparel and footwear even declined (by 2.4% yoy and 0.6% yoy respectively). Deceleration in price growth ranged from 0.5 percentage points for recreation and culture to 1.7 percentage points for alcoholic and tobacco products. Prices of communication and education were the only ones observing accelerated growth in October. Communication prices posted a significant acceleration of 1.0 percentage point to 15.5% yoy, the highest level among all the major groups of goods and services.

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



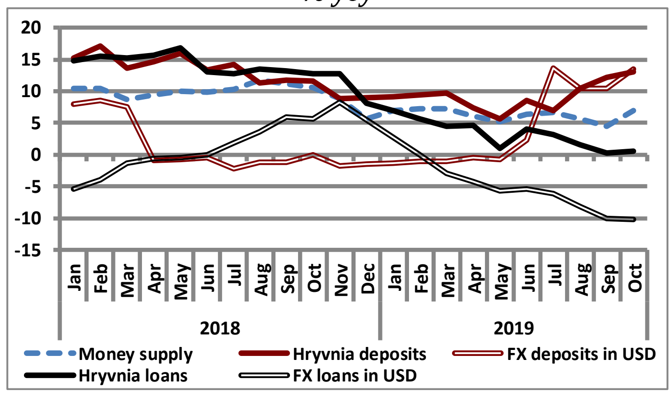
Source: State Statistical Service of Ukraine, The Bleyzer Foundation

Taking into account continuous and rather fast deceleration of consumer prices, we change our forecast of consumer inflation to 7.0% yoy at the end of the year.

Banking Sector. Banking deposits posted a good performance in October. National currency deposits grew by

13.1% yoy, which is 0.9 percentage points faster than in the previous month. This growth was ensured by expansion of both corporate and household deposits at almost identical pace of around 14.5% yoy. Foreign currency deposits denominated in USD expanded 3.1 percentage points faster at 13.5% yoy. Both corporate and household deposits observed faster growth in the reporting month (22.7% yoy and 9.9% yoy respectively).

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



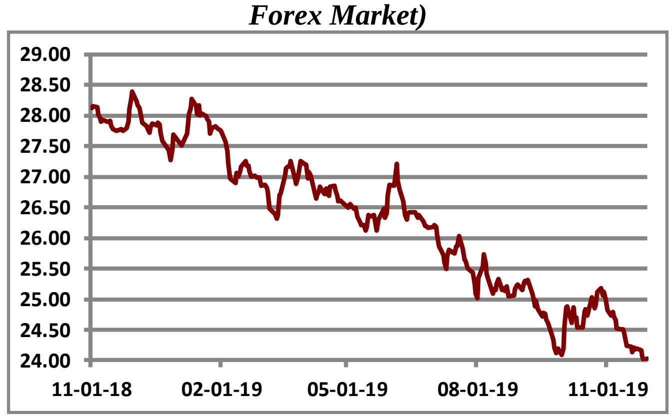
Source: The NBU, The Bleyzer Foundation

Bank lending posted rather sluggish performance again in October. Both hryvnia loans and foreign exchange loans denominated in USD saw little changes in growth dynamics. The former edged up by 0.6% yoy because the decline in corporate sector loans of 6.7% yoy was fully offset fast growth of consumer loans of 25.5% yoy. Foreign exchange loans continued to decline at fast pace of 10.2% yoy due to fast declines in both corporate and household loans (by 8.0% yoy and 24.3% yoy respectively).

Monetary base remained almost unchanged in monthly terms in October. As a result, its year-over-year growth also remained virtually unchanged at 4.0% yoy. In contrast, money supply expanded by 2.0% mom in the reporting month. This caused acceleration in over-year growth by 2.4 percentage points to 6.9% yoy.

The National Bank of Ukraine cut the key policy rate to 13.5% per annum effective 13 December 2019. The NBU accelerated its monetary policy easing, as the rapid appreciation of the hryvnia makes inflationary pressures decline faster than expected.

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



Source: The NBU, The Bleyzer Foundation

Hryvnia Exchange Rate. The UAH/USD exchange rate was on the appreciatory trend almost all November. Appreciation resulted from the effect of several factors. The major two were increased inflow of dollar from non-residents and from exporters, mainly agricultural and metallurgical producers. Non-residents continued purchasing sovereign bonds denominated in hryvnia, while exporters benefited from good harvest and favorable conditions at the world markets. In addition, Naftogaz entered the interbank forex market to sell some funds received from placement of Eurobonds. Overall, the exchange rate appreciated by 2.9% in November.

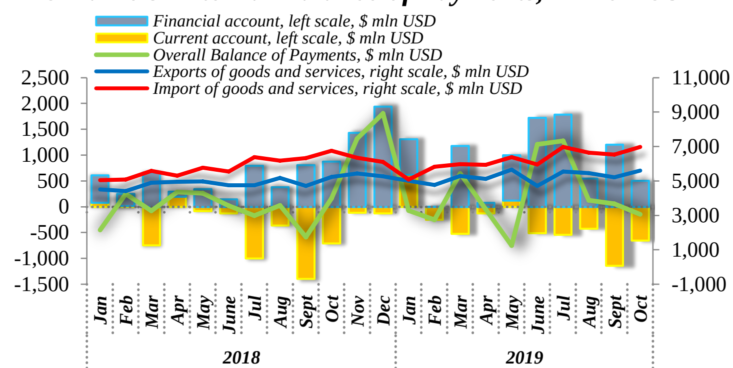
International Trade and Capital

In October, Ukraine's current account deficit declined by 8.4% yoy to USD 651 million, compared to a deficit of USD 711 million in October 2018. This monthly deficit led to a reduction of the cumulative current account deficit by 17% yoy to USD 3,424 million (2.8% of GDP) for January-October 2019.

The major cause of the current account deficit reduction in October was a higher growth of merchandise exports by 7.1% yoy, than the increase in merchandise imports of 2.9% yoy. In addition, the primary income account had a surplus of USD 385 million, due to high growth of employees' compensation by 10.8% yoy to USD 1,166 million in October 2019. At the same time, net secondary income grew by 15% yoy to USD 337 million, compared to the same month of the previous year.

In October 2019, Ukraine's merchandise export amounted to USD 4,222 million. The highest growth rate of merchandised export took place in agricultural products (22.3% yoy), in machinery and equipment (15% yoy), as well as at industrial goods (6.6% yoy). On the other hand, deceleration of exported goods was registered at minerals products (-14.4% yoy), chemicals (-10.7% yoy), timber and wood products (-8.8% yoy), along with metals and informal trade goods (-10.9% yoy).

Ukraine's External Balance of Payments, million USD



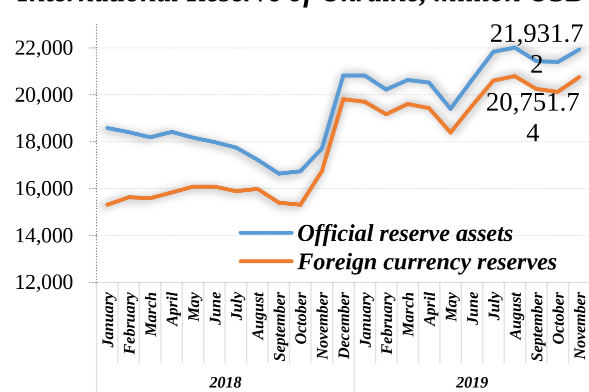
Source: NBU, The Bleyzer Foundation

Regarding the regional destination of merchandised exports, in January-October 2019, Ukrainian goods exports to Russia declined by 12.3% yoy, and reduced Russia's total exports share amount of 5.8%, compared to 7.2% a year ago. On the other hand, Ukraine's exports to Europe increased by 9% yoy, and now represent 38.4% of the total exports, compared to 38.1%, in January–October 2019. Asia's share in total exports increased by 9.7% yoy and grew its shares up to 32.2% of the total.

On the imports side, in October, Ukrainian merchandise imports increased to USD 5,744 million. The highest growth rates of good's imports were in machinery and equipment (19.4% yoy), food products (18.1% yoy) and industrial goods (13.3% yoy). Imported goods with declines included informal trade (-12.7% yoy), metals (-11.1% yoy), timber and wood products (-10% yoy), minerals (-9.1% yoy) and chemicals goods (-6.4% yoy).

Regional-wise, during January-October 2019, the main reduction took place goods imports from Russia with a reduction of 12.7% yoy, which brought the share of imports from Russia down to 11.6% of total imports. On the other hand, imports from the EU increased by 13.6% yoy and now represent 41.9% of total imports. Merchandise imports from Asia showed a large increase of 22.8% yoy, bringing Asia's share in total imports to 25%, from 21.9% a year ago.

International Reserve of Ukraine, million USD



Source: NBU, The Bleyzer Foundation

The October current account deficit was not fully covered by financial account net inflows of USD 503 million, which declined by 42.6 % yoy, mainly due to increased repayments of trade credit (USD 591 million), as well as expansion of the foreign currency cash amounts outside banks (USD 514 million) in October 2019.

As the result, Ukrainian's balance of payments deficit amounted USD 146 million, with the level of international reserves of USD 21.9 billion, as on the 1st November of 2019.

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