

September 2018

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Executive Summary

- ❖ An IMF mission visited Kiev from September 6th to 19th to assess the status of conditionality under the IMF's EFF Program. The mission is still finalizing its work in Washington DC and has not reported its findings yet. The two pending matters are increases in residential gas prices, and issues in the state fiscal budget.
- ❖ In October, the agenda of the Verhovna Rada includes amendments to anticorruption legislation, which should put it in line with the Venice Commission's recommendations. In addition, it is expected that the operations of the State Bureau for Investigation would be fully equipped with the required legal framework.
- ❖ The State Statistics Service has revised upwards its estimate of GDP growth in the second quarter of the year from 3.6% yoy to 3.8 % yoy. This higher-than-expected economic growth follows a first quarter growth rate of 3.1% yoy. The principal drivers of economic growth were strong domestic investments and consumption.
- ❖ The latest monthly data for August 2018 show strong performance by the agricultural sector (with a growth rate of 9.0% yoy), retail trade turnover (7.5% yoy growth rate), and passenger turnover (5.1% yoy growth). On the other hand, Ukrainian industrial output fell by 0.5% yoy in August.
- ❖ The consolidated fiscal budget remains satisfactorily, with a surplus of UAH 27.0 billion in August. For the period January-August, the consolidated surplus expanded to UAH 34.4 billion (about 1.7% of the period GDP.)
- ❖ Consumer inflation remained below 10% in August but above the NBU's target inflation range of 5% ± 1%. The all items index reached 9.0% yoy slightly above 8.9% yoy reported in last month.
- ❖ In the banking sector, both deposits and lending continued to improve in August. Hryvnia deposits expanded by 11.3% yoy while Hryvnia loans expanded by 13.5% yoy. Foreign currency loans almost doubled to 3.6% yoy.
- ❖ Despite some trend reversals during September, the exchange rate remained almost unchanged, finishing the month at around 28.2 UAH/USD.
- ❖ In August 2018, the current account deficit shrank by 45% to USD 0.6 billion, compared to a current account deficit of USD 1.1 billion in July 2018. On a month-to-month basis, exports of goods increased by 12.7 % to USD 3.7 billion, while imports of goods declined by 1.6% mom to USD 5.0 billion. The current account deficit of USD 0.6 billion was fully covered by financial inflows, with the level of international reserves remaining at about USD 17.2 billion.

| Main Macroeconomic Indicators | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018f |
|---|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| <i>GDP, USD billion</i> | 173 | 180 | 130 | 87 | 93.4 | 113 | 125 |
| <i>Real GDP Growth, % yoy</i> | 0.2 | 0.0 | -6.6 | -9.9 | 2.4 | 2.5 | 3.5 |
| <i>Fiscal Balance (incl. Naftogaz/Pension Fund), % of GDP</i> | -5.5 | -6.5 | -11.7 | -2.1 | -2.3 | -1.4 | -2.5 |
| <i>Public Debt, External and Domestic, % of GDP</i> | 36.6 | 40.4 | 69.4 | 79.1 | 80.9 | 71.8 | 67.5 |
| <i>Consumer Inflation, eop, % yoy</i> | -0.2 | 0.5 | 24.9 | 43.3 | 12.4 | 13.7 | 9.0 |
| <i>NBU Key Policy Interest Rate, % eop</i> | 7.5 | 6.5 | 14.0 | 22.0 | 14.0 | 14.5 | 18.0 |
| <i>Hryvnia Exchange Rate per USD, eop</i> | 8.1 | 8.2 | 15.8 | 24.0 | 27.1 | 28.1 | 28.0 |
| <i>Current Account Balance, % of GDP</i> | -8.3 | -9.2 | -3.5 | 1.8 | -1.9 | -2.5 | -3.0 |
| <i>Merchandise Exports, USD billions</i> | 64 | 59 | 51 | 35 | 34 | 40 | 43 |
| <i>Merchandise Imports, USD billions</i> | 86 | 81 | 58 | 39 | 40 | 49 | 52 |
| <i>FDI, Net Annual Inflow, USD billion</i> | 8.4 | 4.5 | 0.4 | 3.0 | 3.3 | 2.3 | 5.0 |
| <i>International Reserves, USD billion</i> | 24.5 | 20.4 | 7.5 | 13.3 | 15.5 | 18.8 | 18.0 |
| <i>Public External Debt, USD billion</i> | 32.1 | 31.7 | 34.9 | 42.6 | 42.5 | 47.0 | 50.0 |
| <i>Private External Debt, USD billion</i> | 102.3 | 110.3 | 91.2 | 76.0 | 69.9 | 70.0 | 71.0 |

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Political and Reform Developments

An IMF mission visited Kiev from September 6th to 19th to assess the status of loan conditionality under the IMF's EFF Program and discuss future financial assistance. The mission is still finalizing its work in Washington DC and has not yet reported its findings. But it has been reported that the two pending issues are increases in residential gas prices to international levels and final settlement of some issues in the state fiscal budget. The government expects that these issues will be resolved in the near future. The possibility of a new IMF Standby program was also discussed during the mission.

In October, the agenda of the Verhovna Rada includes amendments to anticorruption legislation, which should put it in line with the Venice Commission's recommendations. In addition, it is expected that the operations of the State Bureau for Investigation would be fully equipped with the required legal framework. The Bureau is modeled after the US' FBI and should be a powerful mean for fighting corruption in Ukraine.

On September 26th, President Poroshenko participated in the general debates of the 73rd session of the United Nations General Assembly. In order to resolve the conflict with Russia in Eastern Ukraine, President Poroshenko proposed the rapid introduction of UN peace-keepers in the territories in conflict. He noted that preliminary approval was already received from the US, Canada, France, Estonia and several other European states. If implemented, the conflict could be resolved promptly.

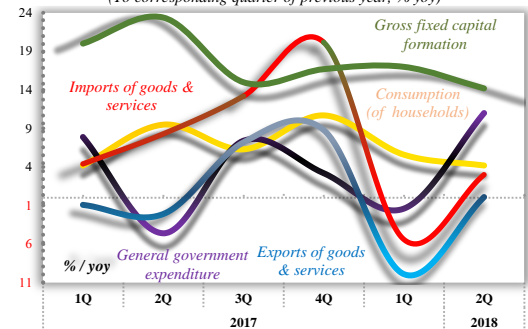
Economic Growth

The State Statistics Service has revised upwards its estimate of GDP growth in the second quarter of the year from 3.6% yoy to 3.8 % yoy. This higher-than-expected economic growth follows a first quarter growth rate of 3.1% yoy. The principal drivers of economic growth were strong domestic investments (14.2% yoy), and domestic consumption, supported by higher wages and foreign remittances. On the supply side of GDP, agriculture provided the highest impetus to GDP growth, with a growth rate of 19.3% yoy, due in part to an early start of the harvesting season. Other subsectors also achieved high rates of growth, including construction (7.2% yoy), electricity, gas, steam & air conditioning supply (6.9% yoy); information & communication (4.7% yoy); real estate activities (3.7% yoy); and wholesale & retail trade (3.4% yoy).

The latest monthly data for August show strong performances by the agricultural sector (with a growth rate of 9.0% yoy), retail trade turnover (7.5% yoy growth rate), and passenger turnover (5.1% yoy growth rate). On the other hand, Ukrainian industrial output fell by 0.5% yoy in August 2018, following an increase of 2.9% yoy in the previous month. This decline was due in part to increasing difficulties in freight transportation through the Sea of Azov caused by Russian interferences. But it was also caused by repair and maintenance works in a large number of industrial plants. Almost all manufacturing sectors suffered output declines in August on a year-to-year basis, except for metals (1.7% yoy) and chemicals (10.3% yoy) products. The industrial

Expenditure side of the GDP of Q2 2018

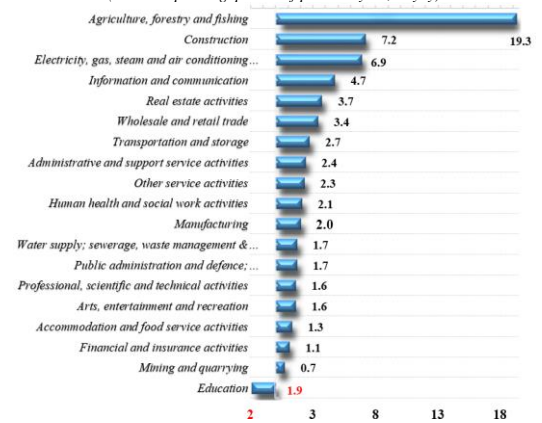
(To corresponding quarter of previous year, % yoy)



Source: The Bleyzer Foundation

GDP production side of Q2 2018

(To corresponding quarter of previous year, % yoy)



Source: The Bleyzer Foundation

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sectors showing output decreases were the following: coke & refined petroleum products (-7.6% yoy); pharmaceutical products (-6.5% yoy); wood products, paper & printing (-1.9% yoy); textile industry (-1.7% yoy); machinery & equipment (-1.5% yoy); furniture (-1.1% yoy); foodstuffs (-1% yoy); and rubber & plastic products (-0.2% yoy).

From a regional distribution point of view, in August 2018 industrial output increased of the following oblasts: Sumy (13% yoy), Luhansk (12% yoy), Kharkiv (10.6% yoy), Chernivtsi (8.2% yoy), Chernihiv (7.2% yoy), Ivano-Frankivsk (7.1% yoy), Ternopil (6.1% yoy), Mikolayiv (4.9% yoy), Zakarpattya (4.6% yoy), Volyn (4.5% yoy), Kherson (4.3% yoy), and Khmelnytskyi (3.6% yoy). On the other side, in August 2018, negative results took place in the following oblasts: Odesa (-24.7% yoy), Zhytomyr (-6.5% yoy), Vinnytsya (-6% yoy), Rivne (-5.9% yoy), Donetsk (-5.6% yoy), Cherkasy (-4.0% yoy), Zaporizhzhya (-3% yoy), Kyiv city (-2.9% yoy), Kyiv (-2.2% yoy), Lviv (-0.7% yoy), Dnipropetrovsk (-0.5% yoy), Kirovohrad (-0.3% yoy), and Poltava (-0.2% yoy).

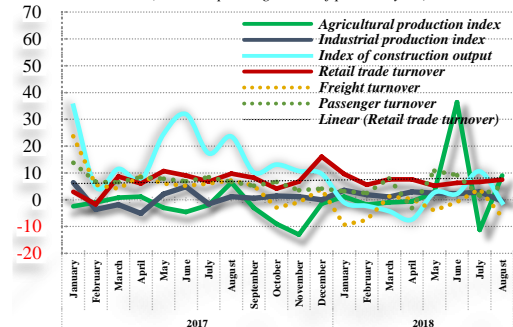
Fiscal Policy

The consolidated fiscal budget remains satisfactorily, with a surplus of UAH 27.0 billion in August. Surpluses were observed at both central state and local levels. The central state budget was executed with a surplus of UAH 25.2 billion mainly due to sharp deceleration in growth of expenditures. The cumulative surplus of local budgets was much smaller at about UAH 1.7 billion. The government borrowed Hryvnias to repay public debt, decreasing cumulative net repayments from the beginning of the year by around UAH 14.4 billion. At the same time, tight monetary policy withdrew significant amounts of cash resources in a quest to control inflation. UAH 40.5 billion of withdrawn cash more than offset new borrowings of the government. The January-August cumulative consolidated budget surplus expanded to UAH 34.4 billion, which is around 1.7% of the period GDP.

Consolidated budget revenues continued to grow at high rates in August although the pace of growth decelerated as compared to July. The 17.1% yoy increase was 2.0 percentage points below that observed in the previous month and was driven by expansion of both tax and nontax revenues. The former grew faster at 17.7% yoy mainly on the back of receipts from personal income taxes (which grew by 24.0% yoy), corporate profit tax (grew by 30.9% yoy), and internal taxes on goods and services (expanded by 22.3% yoy). In particular, among internal taxes on goods and services, the fastest growth was observed in receipts from VATs (23.3% yoy on goods of domestic production and 24.9% yoy on imported goods). The 10.3% yoy growth of nontax revenues was mainly ensured by NBU's transfers to the budget of its last year's profits. Growth of cumulative consolidated budget revenues saw little changes for the third month in a row being at 15.3% yoy in January-August 2018.

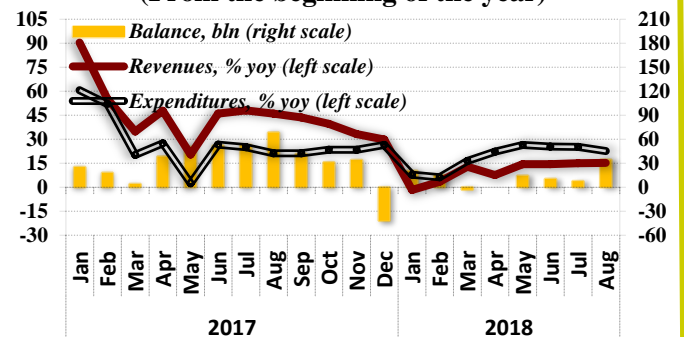
Ukraine Economic Performance, % yoy

(To corresponding month of previous year)



Source: State Statistics Committee, the Bleyzer Foundation

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



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

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Growth of the consolidated budget expenditures significantly decelerated in August. The year-on-year growth of 7.1% was more than three times lower compared to July. Such a deceleration in growth took place because of reductions in both current and capital expenditures; but the former saw a more significant deceleration (from 19.7% yoy to just 2.5% yoy). Current expenditures decelerated in growth mainly because of decline in social security expenditures (by 20.1% yoy) and expenditures on debt servicing (by 20.6% yoy), particularly domestic debt servicing. Other groups of current expenditures also experienced deceleration in growth. Only payroll expenditures grew at high rates (27.5% yoy). Capital expenditures expanded by 51.4% yoy which is 14.8 percentage points less than in July. Growth of cumulative consolidated budget expenditures further decelerated to 22.7% yoy in January-August.

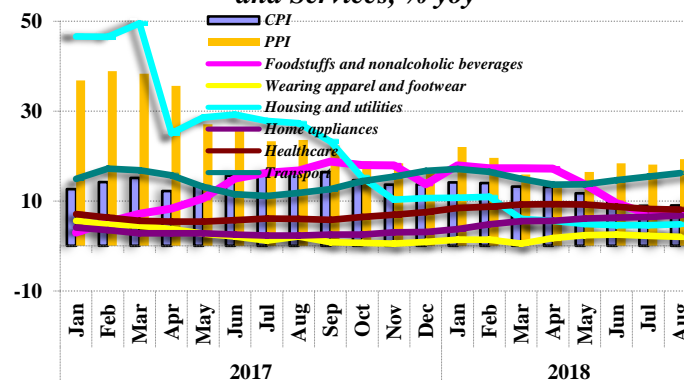
Payments by the government and the NBU on external debt servicing significantly expanded in August. The government and the NBU paid USD 607.4 million equivalent to the IMF. Other principal and servicing payments on state debt denominated in foreign currency totaled USD 447.9 million equivalent, of which USD 389.2 million were principal and servicing payments on state securities.

Monetary Policy

Inflation. Consumer inflation remained below 10% in August but above the NBU's target inflation range of $5\% \pm 1\%$. The all items index reached 9.0% yoy slightly above 8.9% yoy reported in last month. Similarly, core inflation inched down just by 0.1 percentage point to 8.7% yoy.

As in July, only a few major groups of goods and services recorded notable changes in prices. Deceleration in growth of prices took place in alcohol and tobacco products (from 18.5% yoy to 17.9% yoy) and in restaurants and hotels (from 15.3% yoy to 14.7% yoy). Transport and recreation and culture reported some increases in price growth (from 15.4% yoy to 16.2% yoy and from 3.7% yoy to 4.2% yoy).

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



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

The Board of the NBU decided to raise the policy interest rate by 0.5 percentage points to 18% starting on September 7th due to greater inflationary risks associated both with unfavorable export prices and with domestic demand growth. The regulator was concerned that these factors may prevent the inflation rate from reaching the medium-term target band of $5\% \pm 1\%$. Taking this into account and observing the latest available information, we decided to leave our inflation forecast unchanged at 9.0% yoy for 2018.

Banking Sector. Bank deposits continued to improve in August. National currency deposits expanded by 11.3% yoy, with household deposits increasing by 18.2% yoy and corporate deposits rising by 5.1% yoy. Although substantive, these rates were lower than in the previous month because companies had to pay quarterly taxes, while households had additional expenditures in order to prepare children for school. Growth of foreign currency deposits denominated in USD remained negative, although the decline decelerated to 1.2% yoy.

Bank lending activities further intensified in August, in both national and foreign currencies. The growth of national currency loans accelerated to 13.5% yoy, while the growth of foreign currency loans denominated in USD almost doubled to 3.6% yoy. Acceleration in the growth of national currency loans was the result of faster expansion of corporate loans (at 7.0% yoy) which more than offset some deceleration in growth of household

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loans (to 44.7% yoy). Regarding foreign currency loans, loans to households slowed down to 8.6% yoy, while loans of the corporate sector grew at a rate of 6.2% yoy.

The monetary base remained virtually unchanged in August as compared to July. Increases of funds at the correspondent accounts of banks were offset by declines in currency resources. In year-over-year terms, the monetary base grew at slightly accelerated rate of 11.3%. A similar situation was observed with money supply in August. It posted just a minor increase of 0.3% in monthly terms but expanded at high rate of 11.7% on a year-over-year basis.

Hryvnia Exchange Rate. The UAH/USD exchange rate posted several trend changes during September. As non-residents increased their dollar purchases, the exchange rate depreciated over the first couple of trading sessions of the month. Then, decrease in demand for dollar by non-residents and increased dollar supply by exporters led to a gradual appreciation of the exchange rate. The exchange rate remained relatively stable from September 12th until September 25th. Finally, the exchange rate depreciated again during the last week of the month because of VAT reimbursements to exporters, which expanded Hryvnia resources at the market. Overall, the exchange rate remained almost unchanged finishing the month at around 28.22 UAH/USD.

International Trade and Capital

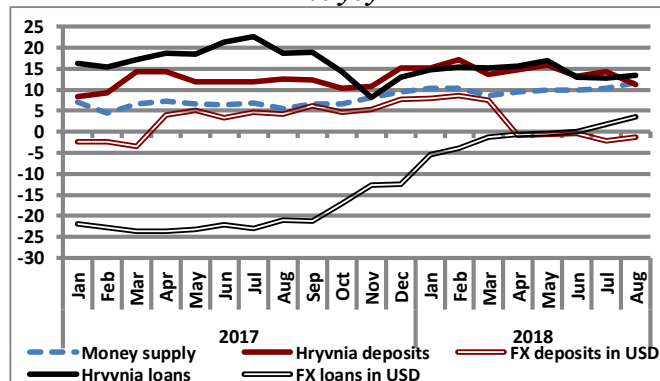
In August 2018, the current account deficit shrank by 45% to USD 0.6 billion, compared to a current account deficit of USD 1.1 billion in July 2018. On a month-to-month basis, exports of goods increased by 12.7% to USD 3.7 billion. This increase in exports was due principally to increased exports of agricultural products, which expanded by 27.3% mom to USD 1.6 billion, or 43% of total exports. On the other hand, imports of goods declined by 1.6% mom to USD 5.0 billion.

The August deficit in the trade of goods of USD 1.3 billion was partly offset by surpluses in primary and secondary foreign income of USD 0.6 billion and by a surplus in service exports of USD 0.1 billion.

On a year-over-year basis, in August 2018 the largest increases in exports took place in mineral products (28% yoy), followed timber & wood products (17.9% yoy), machinery & equipment (12.1% yoy), industrial goods (11.8% yoy), metals (11.2% yoy), other informal trade (9% yoy), chemicals (7.3% yoy), and agricultural products (6.5% yoy).

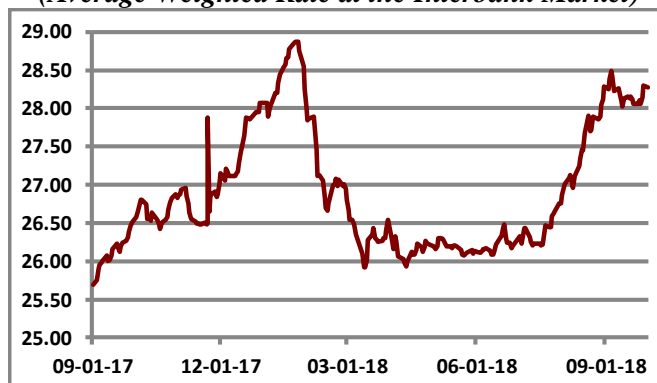
On the import side, the major expansion of imported goods took place in industrial goods (36.4% yoy), metals (31.6% yoy), other informal trade (26% yoy), machinery & equipment (20.5% yoy), mineral products (15.4%

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



Source: The NBU, The Bleyzer Foundation

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



Source: The NBU, The Bleyzer Foundation

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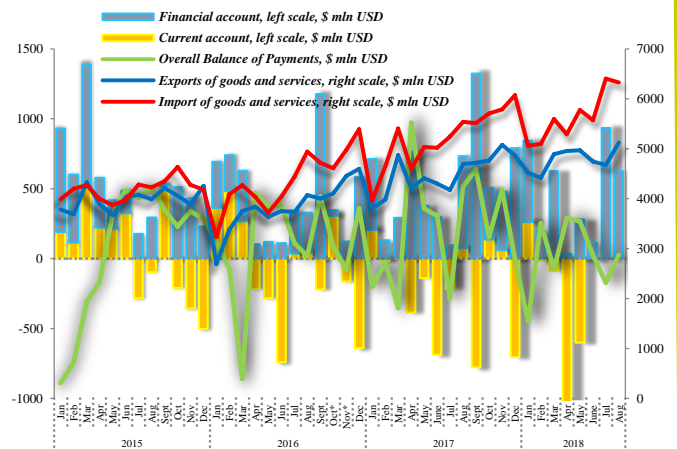
yoy), agricultural products (13.1% yoy), timber & wood products (11% yoy), and chemicals (5% yoy).

Regarding regional trade distribution, in January-August 2018, Ukrainian exports to Europe increased by 18.2% yoy, increase the share of Europe to 37.8% of the total. On the other hand, the share of Asia declined slightly to 31.6% of total exports (despite a 10.4% yoy growth). The share of Russia in Ukrainian exports fell to 7.2% of the total, as exports to Russia declined by 9.1% yoy during the period. On the imports side, during January-August 2018, the main supplier of Ukraine continues to be Europe, with 40.4% share in total Ukrainian imports (and with an 11.6% yoy growth). The share of Asia advanced by 1.3% to 21.3% of Ukrainian imports (23.3% yoy growth). Russia continued to increase its own share of imported goods to Ukraine to 14.3% of the total amount of imports (with a 21.4% yoy growth). Therefore, Ukrainian trade imbalance with Russia reached USD 3.0 billion in January-August 2018, compared to USD 1.9 billion a year ago.

The August 2018 current account deficit of USD 601 million was fully compensated by financial account inflows of USD 625 million. These financial inflows resulted from the placement by the government of USD 648 million of discount Eurobonds and by foreign direct investments of USD 176 million.

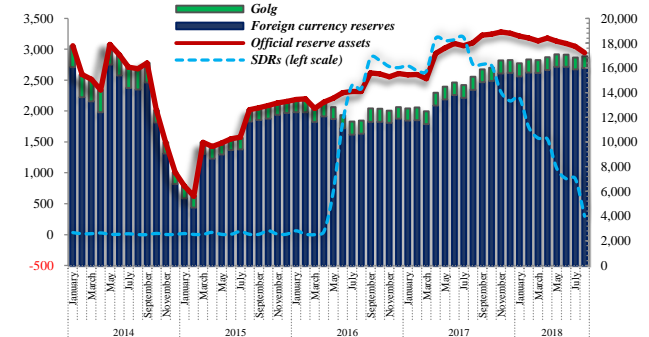
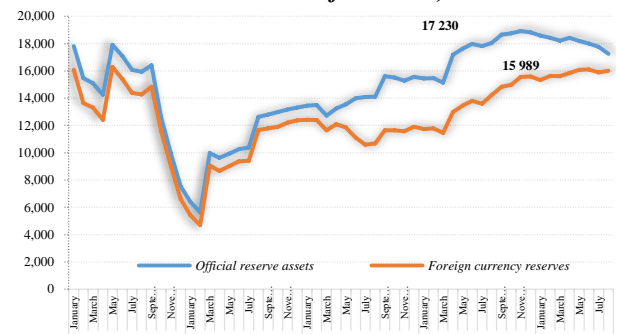
As a result, the overall balance of payments in August 2018 had a small surplus of USD 27 million. International reserves remained at about USD 17.2 billion. After USD 521 million in repayment to the IMF, international reserves amounted to USD 17.2 billion (covering 2.9 months of future imports), as of September 1st, 2018.

Ukraine's External Balance of Payments, mln USD



Source: NBU, The Bleyzer Foundation

International Reserve of Ukraine, million USD



Source: NBU, The Bleyzer Foundation

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