

July 2018

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

Executive Summary

- ❖ In July, the Verhovna Rada passed amendments to the Anti-Corruption Court Law according to which all ongoing cases of the National Anticorruption Bureau will be transferred to the new Anticorruption Court. This amendment was required by the IMF Program and should ensure renewed international financial support.
- ❖ The IMF has indicated that an IMF mission will be visiting Kyiv from September 6 to September 19, to discuss recent economic developments and next steps, including further financial assistance from the IMF.
- ❖ In July President Poroshenko participated in the 2018 Brussels Summit of the North Atlantic Treaty Organization (NATO), which was attended by heads of government of NATO members. The final declaration signed by all member-states re-confirmed NATO support to Ukraine in its efforts to maintain the country's territorial integrity.
- ❖ The most recent monthly data for June 2018 shows that the economy is continuing its recovery. In fact, in June agricultural production climbed by 36% yoy, following a 2.6% yoy increase in May. The industrial sector continued to growth, but at a more moderate rate of 2.2% yoy. Retail trade turnover continued to show improvements, with a growth rate of 5.8% yoy in June 2018, thanks in part to increases in real monthly wages of 13% yoy.
- ❖ In June both the central and local governments incurred budget deficits, which led to a consolidated budget deficit of UAH 4.2 billion for the month. Nevertheless, from the beginning of the year, the cumulative consolidated budget balance remained positive at UAH 10.4 billion in the first half of 2018 (a surplus of 0.3% of period GDP).
- ❖ Consumer inflation posted a significant deceleration for the second consecutive month in June. The all items index dropped 1.8 percentage points to 9.9% yoy.
- ❖ The UAH/USD exchange rate depreciated starting in mid-July and was triggered by expanded hryvnia resources in the FX market because of repayment of bonds denominated in Hryvnia and several tranches of VAT reimbursements. It also was supported by increased demand for dollars by non-resident banks for dividend repatriation purposes.
- ❖ In June 2018, the current account of the balance of payments incurred a deficit of USD 125 million (1.2% of period GDP), following a small surplus of USD 37 million during the second quarter of 2018. The June deficit took place despite the fact that exports of goods increased by 11.5% yoy, a larger increase than the 9.9% rise of imports of goods. Nevertheless, financial inflows of USD 148 million led to an overall balance of payments surplus, with international reserves remaining at USD 18 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	14.5	17.0	16.7	16.4	17.0
<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	21.0
<i>Public External Debt, USD billion</i>	32.1	31.7	34.9	42.6	42.5	47.0	52.0
<i>Private External Debt, USD billion</i>	102.3	110.3	91.2	76.0	69.9	70.0	72.0

July 2018

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

Political and Reform Developments

In July, the Verhovna Rada passed amendments to the Anti-Corruption Court Law according to which all ongoing cases of the National Anticorruption Bureau of Ukraine will be transferred to the Anticorruption Court. This amendment was required by the IMF Program and by Ukraine's international partners. The approval of the Law should ensure renewed international financial support to Ukraine.

The IMF has indicated that an IMF mission will be visiting Kyiv from September 6 to September 19, to discuss recent economic developments and policies. The mission will also discuss next steps, including financial assistance from the IMF in support of policies to maintain macroeconomic stability and keep the economy on a path toward sustainable and inclusive growth.

In July President Poroshenko participated in the 2018 Brussels Summit of the North Atlantic Treaty Organization (NATO), which was attended by heads of state and heads of government of NATO members. The final declaration signed by all member-states re-confirmed NATO support to Ukraine in its efforts to keep the country's territorial integrity. Ukraine's security situation was also discussed by the presidents of Russia and the United States during their joint press conference in Finland. According to the statement issued by the U.S. Special Representative for Ukraine Negotiations Kurt Volker "... the United States does not recognize the annexation of Crimea and occupation of Donbas." These gatherings show that Ukraine continues to receive wide international support on its struggle with Russia for its territorial integrity.

Economic Growth

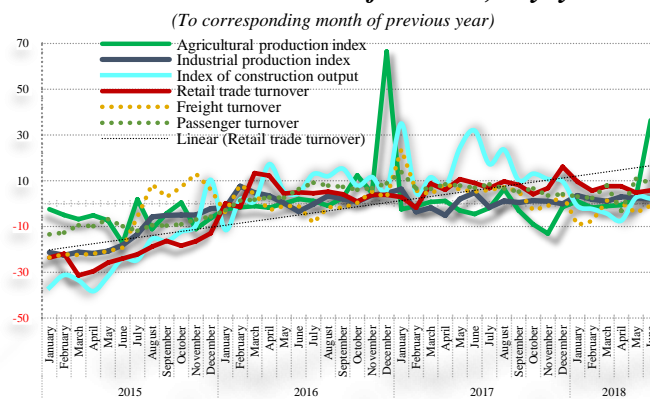
The most recent monthly data for June 2018 show that the economy is continuing its recovery. In fact, in June agricultural production climbed by 36% yoy, following a 2.6% yoy increase in May. The industrial sector continued to growth, but at a more moderate rate of 2.2% yoy, compared to 2.5% in May. This industrial moderation was due to a decline in mining output.

Within the industrial sector, manufacturing increased by 2.8% yoy in June, while mining declined by -0.6% yoy, and electricity, gas, and a/c supply increased by 4.8% yoy.

Within the manufacturing sector, in June 2018 production increases took place in the following areas: chemicals & chemical products (30.3% yoy), furniture (5.6% yoy), engineering (4.8% yoy), basic metal products (3.3% yoy), rubber & plastic products (1% yoy), foodstuffs (0.7% yoy), wood products (0.6% yoy), and coke with refined petroleum products (0.3% yoy). Declines in production took place in the of textile industry (-6.3% yoy), basic pharmaceutical products (-6.2% yoy), extraction of crude petroleum and natural gas (-0.6% yoy).

In terms of types of industrial products by end use (main industrial groupings), in June 2018 the highest increases took place in capital goods (8.2% yoy), followed by energy goods (2.4% yoy), and by intermediate goods (1.7% yoy). On the other hand, consumer durables and non-durables experienced declines (-6.9% yoy and -0.8% yoy, respectively) in June 2018.

Ukraine Economic Performance, % yoy



Source: State Statistics Committee, the Bleyzer Foundation

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

July 2018

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

With regard to the geographical distribution of industrial output growth, in June 2018 the largest production increases took place in the following regions: Ivano-Frankivsk (11.7% yoy), Volyn (10.7% yoy), Donetsk (7.4% yoy), Zakarpattia (7% yoy), Luhansk (7% yoy), Chernivtsi (6.7% yoy), Sumy (4.8% yoy), Zaporizhzhya (3.6% yoy), Kharkiv (3.4% yoy), Cherkasy (3.3% yoy), Ternopil (3.2% yoy), Dnipropetrovsk (2.3% yoy), Lviv (1.8% yoy), Poltava (1.4% yoy), Kyiv (0.9% yoy) and Khmelnytskiy (0.4% yoy).

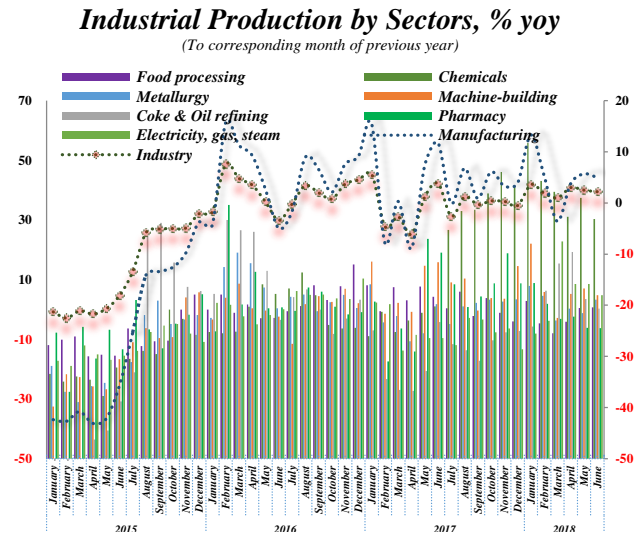
On the other hand, eight oblasts experienced industrial production reductions, in particularly Rivne (-15.7% yoy), Odesa (-14.3% yoy), Kirovohrad (-3.8% yoy), Mikolayiv (-1.4% yoy), Chernihiv (-1.3% yoy), Vinnytsya (-0.7% yoy), Zhytomyr and Kherson (-0.2% yoy).

Other economic activities of Ukraine had mixed results. On the positive side, retail trade turnover continued to show significant improvements, with a growth rate of 5.8% yoy in June 2018. This improvement was supported by increases in nominal and real average monthly wages of 24.2% yoy and 13% yoy, respectively. Construction output increased at a moderate rate of 2.2% yoy. Passenger turnover expanded by 9.2% yoy; but freight turnover declined by -0.9% yoy.

Fiscal Policy

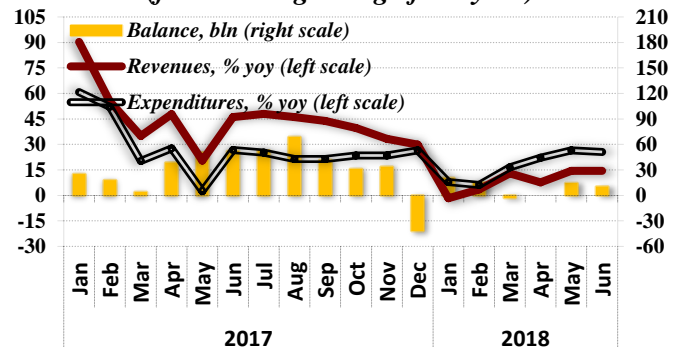
In June both the central and local governments incurred budget deficits, which led to a consolidated budget deficit of UAH 4.2 billion for the month. The largest deficit took place at the local level (UAH 3.6 billion), while the deficit of the state budget amounted to UAH 0.6 billion. The consolidated budget deficit of June was financed through additional cash resources (UAH 2.7 billion), other instruments of liquidity regulation (UAH 1.1 billion), and loans (net loans totalled UAH 0.4 billion.) From the beginning of the year, the cumulative consolidated budget balance remained positive at UAH 10.4 billion in the first half of 2018 (0.3% of period GDP).

Growth of consolidated budget revenues decelerated in June. The 14% yoy growth was almost three times lower than in May. Tax revenues expanded by 17.1% yoy, while nontax revenues grew by 7.7% yoy. Deceleration in growth of the tax revenues by more than 10 percentage points was the result of slower growth in import taxes and a reversal of the trend in growth of receipts from corporate profit tax (decline by 45.9% yoy as compared to growth of 43.7% yoy in the previous month). At the same time, growth of receipts from personal income tax and from VAT remained high (24.0% yoy and 42.4% yoy, respectively). Growth of cumulative



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

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

July 2018

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

consolidated budget revenues remained almost unchanged at 14.4% yoy in the first half of 2018.

On the expenditures side, consolidated budget expenditures saw their growth decelerating in June but at slower pace compared to revenues. Their growth more than halved to 21.0% yoy. Both current and capital expenditures posted increases but the later grew much faster (61.1% yoy versus 17.7% yoy). Deceleration in growth of current expenditures by almost 2.5 times was the result of decline in spending on debt servicing (by 27.2% yoy), deceleration in growth on social security (to 19.7% yoy) thanks to higher receipts from the single social payment to the Pension Fund, and slower growth of spending on goods and services (12.7% yoy). Growth of payroll expenditures, though, remained high at 33.2% yoy. Growth of the cumulative consolidated budget expenditures slightly decelerated (to 25.5% yoy) in January-June.

Payments of the government and the NBU on external debt servicing increased again in June. In particular, USD 162.0 million equivalent was paid to the IMF. Principal and servicing payments on state debt denominated in foreign currency totaled USD 562.4 million, including payments on sovereign bonds of USD 552.5 million. In addition, the government spent around UAH 6 billion on repayment of sovereign bonds denominated in Hryvnia on July 16th-20th.

Monetary Policy

Inflation. Consumer inflation posted a significant deceleration for the second consecutive month in June. The all items index dropped 1.8 percentage points to 9.9% yoy. This deceleration in price growth was caused by a significant increase in the supply of foodstuffs, including whole foods, thanks to better weather conditions this year, and by increased imports. Core inflation also slowed to 9.0% yoy.

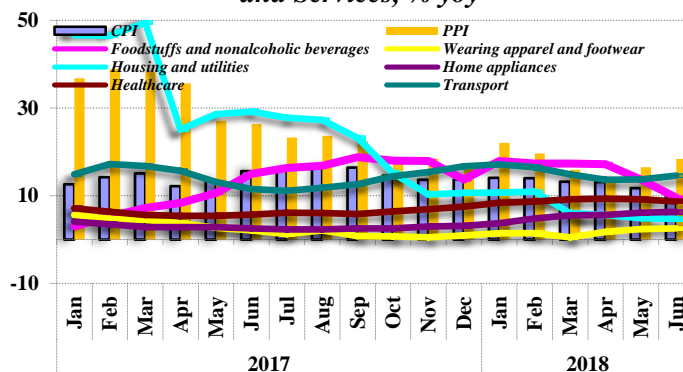
Most of the major groups of goods and services saw little changes in price dynamics in June. The most significant deceleration in price growth was reported for foodstuffs (from 13.7% yoy to 9.5% yoy). Notable deceleration

in growth of prices was also observed for alcoholic and tobacco products (by 1.1 percentage points to 18.3% yoy) and recreation and culture services (by 0.6 percentage points to 3.7% yoy). Significant acceleration in price growth was reported for transport (by 0.9 percentage points to 14.6% yoy). Changes in price dynamics of the other major groups of goods and services did not exceed 0.5 percentage points.

The NBU increased the policy interest rate to 17.5% basing on its mid-term inflation projections to reach the inflation targets for 2018-2020. Taking this into account and observed inflation dynamics, we decided to leave our inflation forecast intact at 9.0% yoy for 2018.

Banking Sector. The evolution of bank deposits posted mixed developments in June. National currency deposits saw some deceleration in growth, while foreign currency deposits denominated in USD saw minor deceleration in their decline. Growth of national currency deposits decelerated due to a significant decline in the growth of corporate deposits (from 11.6% yoy to 3.9% yoy). Corporate bank deposits declined due to the transfer of funds to the state budget for payments related to the share of statutory funds belonging to the state. Growth of the household national currency deposits accelerated from 19.4% yoy to 22.0% yoy. Growth of both

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



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

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

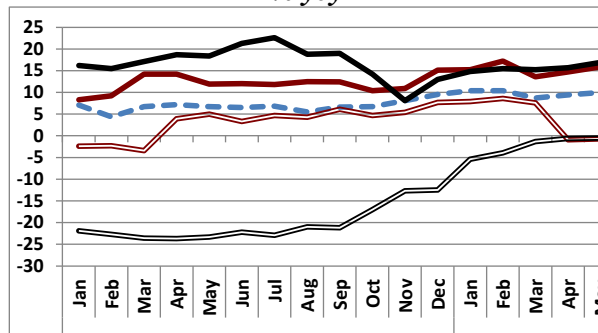
July 2018

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

corporate and household foreign currency deposits denominated in USD remained almost unchanged.

Similarly to deposits, bank lending saw deceleration in growth of Hryvnia loans in June, while foreign currency loans posted some improvements. Deceleration in growth of national currency loans (to 13.1% yoy) was the result of slower growth in corporate loans (7.2% yoy). Growth of household Hryvnia loans also slightly decelerated but remained high at 44.4% yoy. The decline of foreign currency loans denominated in USD was contained thanks to a further acceleration of corporate loans (to 3.8% yoy). The situation with household loans in USD did not change much (declined by 18.1% yoy).

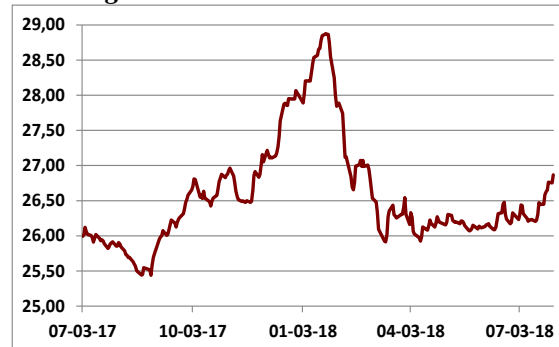
Dynamics of Money Supply, Deposits, and Loans, % yoy



The monetary base increased by 3.1% mom because of seasonal growth of cash resources. However, statistical base effects led to deceleration in year-over-year growth of the monetary base to 10.0%. Similarly, money supply expanded by 1.2% mom in June thanks to mentioned growth in cash resources and to inflow of deposits. The over-year growth of the monetary base, though, further decelerated to 9.9%.

Hryvnia Exchange Rate. The UAH/USD exchange rate was stable in the first half of July with the exception of July 4th, when a one-day depreciation was the result of the closure of the world dollar market on US Independence Day. In the second half of July, a relatively fast depreciation started on July 17th and lasted until the end of the month. This depreciation was triggered by expanded hryvnia resources in the FX market because of repayment of bonds denominated in Hryvnia and several tranches of VAT reimbursements. It also was supported by increased demand for dollars by non-resident banks which purchased dollar for dividend repatriation purposes. In addition, the cash foreign exchange market depreciated faster which led speculators to divert trade out of the interbank market and into the cash market to maximize gains. The NBU was ineffective in its attempts to smooth fluctuations of the exchange rate through dollar interventions. Those interventions were either too small in size or were made in the wrong time, thus, had little effect on exchange rate dynamics.

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



Source: The NBU, The Bleyzer Foundation

International Trade and Capital

In June 2018, the current account of the balance of payments incurred a deficit of USD 125 million (1.2% of period GDP), following a small surplus of USD 37 million during the second quarter of 2018. The June deficit was caused by an increased deficit in foreign trade of goods, which reached USD 823 million, compared to the previous year deficit of USD 794 million in June 2017. This deficit took place despite the fact that exports of goods increased by 11.5% yoy, a larger increase than the 9.9% rise of imports of goods.

In June the highest growth rate in exports, comparing to the previous year, took place in ferrous & nonferrous metals (35.2% yoy), followed by chemicals (22.6% yoy), timber with wood products (18.6% yoy) and mineral products (11.5% yoy). In addition exports of industrial goods expanded by 5.4% yoy, and machinery &

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

July 2018

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

equipment by 1.9% yoy. However, two groups of exported products showed reductions: agriculture and informal trade (-0.4% yoy and -21.4% yoy, respectively).

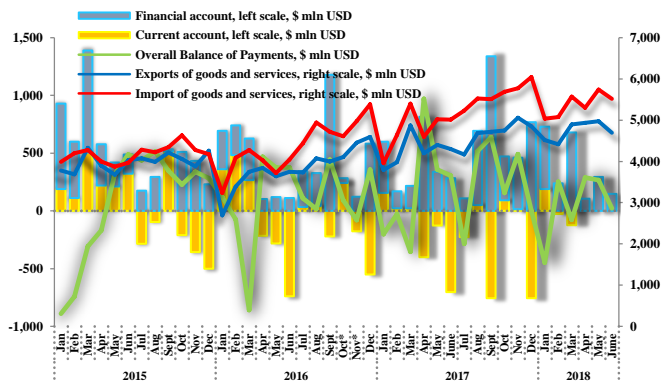
Ukraine's merchandised import in June 2018 showed increases in the following products groups: mineral products by 32.6% yoy, agricultural products by 22.5% yoy, timber & wood products by 14.8% yoy, other informal trade 7.9% yoy, industrial goods by 3.4% yoy, and metals by 1.4% yoy. Declines in imports took place in machinery & equipment (-0.1% yoy), and chemicals (-1.9% yoy),

Regarding the geographical distribution of merchandised trade of Ukraine, in January-June 2018 the largest deficit of trade turnover was with the Russian Federation which grew by 68% yoy to USD 2.2 billion. The trade deficit with CIS countries reached USD 3.1 billion during that period. In fact, merchandised export to Russia declined by 7.6% yoy (to USD 1.5 billion), while import increased by 25.7% yoy to USD 3.7 billion in January-June 2018. At the same time, merchandised trade with Europe both in exports and in import by 18.4% yoy (to USD 8 billion) and 9.9% yoy (to USD 10.3 billion), respectively.

Ukrainian financial account net inflow amounted to USD 148 million in June 2018. These inflows were the result of large foreign direct investments, net inflow of which amounted to USD 462 million. About 67% of the inflows represented banking sector operations with debt transferred to the statutory capital. Loan repayments of Ukraine to the IMF accumulated USD 162 million.

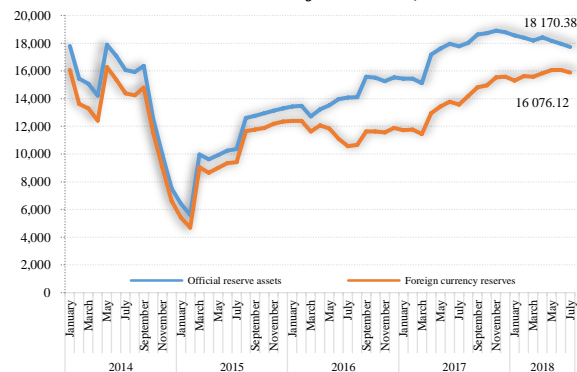
As the result, these financial inflows were able to compensate the current account deficit. The overall surplus of Ukraine's consolidated balance of payments amounted to USD 23 million, leading to an increase in the level of international reserves to USD 18 billion (equivalent to 3.1 months of imports).

Ukraine's External Balance of Payments, mln USD



Source: NBU, The Bleyzer Foundation

International Reserve of Ukraine, mln USD



Source: NBU, The Bleyzer Foundation

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