

January 2020

*Oleg Ustenko, Julia Segura, Valentyn Povroznyuk  
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### *Executive Summary*

- ❖ A major positive event at the end of 2019 was the finalization of the contract with Gazprom for the transportation of Russian gas through Ukraine. The gas transit contract is for 5 years. It should ensure normal work of the Ukrainian gas transportation system, and exclude major risks for energy supply to the various regions of the country. Moreover, Gazprom transferred to Ukraine USD 3 billion due under the Stockholm Arbitration Institute's decision on the gas transit litigation.
- ❖ At the end of December, Ukrainian prisoners of war and civilians arrested by the pro-Russian militants in Donbas returned to Ukraine, as agreed at the Normandy summit in Paris on December 9.
- ❖ The most recent data for November show that economic growth may have slowed down in the fourth quarter of 2019, which may lead to a GDP growth rate of 3.6% for 2019. In fact, in November 2019, Ukrainian's agricultural output declined by 18.5% yoy, comparing to the same month of the previous year. Similarly, Ukrainian industrial sector continued its weak performance of the previous months, with an output decline of 7.5% yoy.
- ❖ The consolidated fiscal budget was in deficit in November. The cumulative consolidated budget deficit from the beginning of the year increased to UAH 6.8 billion in January-November (about 0.2% of period GDP).
- ❖ Consumer inflation sustained a significant drop in November. The all items index decreased by 1.4 percentage points to 5.1% yoy on the back of strict monetary policy and further hryvnia strengthening.
- ❖ Banking deposits expanded at accelerated pace in November. National currency deposits increased by 16.9% yoy, while that of the foreign currency deposits denominated in USD increased by 19.2% yoy. However, bank lending activities continued to be sluggish in November.
- ❖ In December, 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).
- ❖ In November 2019, Ukraine's current account had a surplus of USD 57 million, thanks to a growth of 43.7% yoy (to USD 714 million) of net primary income (principally compensation of employees). Together with financial inflows of USD 544 million in November, the overall balance of payments had a surplus of USD 601 million, increasing international reserves to USD 25.3 billion.

<b>Main Macroeconomic Indicators</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019e</b>	<b>2020f</b>
<i>GDP, USD billion</i>	180	130	87	93.4	113	131	154	174
<i>Real GDP Growth, % yoy</i>	0.0	-6.6	-9.9	2.4	2.5	3.3	3.6	3.8
<i>Fiscal Balance (incl.Naftogaz/Pen Fund),% of GDP</i>	-6.5	-11.7	-2.1	-2.3	-1.4	-1.9	-2.1	-2.0
<i>Public Debt, External and Domestic, % of GDP</i>	40.4	69.4	79.1	80.9	71.8	60.9	56.0	55.0
<i>Consumer Inflation, eop, % yoy</i>	0.5	24.9	43.3	12.4	13.7	9.8	4.1	5.5
<i>NBU Key Policy Interest Rate, % eop</i>	6.5	14.0	22.0	14.0	14.5	18.0	13.5	9.8
<i>Hryvnia Exchange Rate per USD, eop</i>	8.2	15.8	24.0	27.1	28.1	27.7	23.7	26.0
<i>Current Account Balance, % of GDP</i>	-9.2	-3.5	1.8	-1.5	-2.2	-3.3	-3.0	-3.1
<i>Merchandise Exports, USD billions</i>	59	51	35	34	40	43	46	49
<i>Merchandise Imports, USD billions</i>	81	58	39	40	49	56	59	63
<i>FDI, Net Annual Inflow, USD billion</i>	4.5	0.4	3.0	3.3	2.3	2.4	2.0	2.5
<i>International Reserves, USD billion</i>	20.4	7.5	13.3	15.5	18.8	20.8	25.3	24.0
<i>Public External Debt, USD billion</i>	31.7	34.9	42.6	42.5	47.0	49.9	50.2	53.0
<i>Private External Debt, USD billion</i>	110.3	91.2	76.0	69.9	70.0	71.0	72.0	74.0

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### **Political and Reform Developments**

On December 31, President Zelenskyy delivered his New Year Address to the nation. The main messages were as follows: (i) the main priority of the administration is to make progress in its peace efforts and in military conflict resolution; (ii) accelerating economic growth was defined as a precondition for improving the lives of citizens and for fighting poverty; (iii) the main measurement of the effectiveness of state policies was defined as a decrease and, finally, stop of emigration from the country; (iv) the President confirmed that the financial state of the economy has been rapidly improving; (v) the country will accelerate its efforts in improving the quality of the business climate by fighting corruption and implementing judicial system reform.

A major positive event at the end of 2019 has been the finalization of the contract with Gazprom for the transportation of Russian gas through Ukraine. The gas transit contract is for 5 years. It should ensure normal work of the Ukrainian gas transportation system, and exclude major risks for energy supply to the various regions of the country. Moreover, Gazprom transferred to Ukraine USD 3 billion due under the Stockholm Arbitration Institute's decision on the gas transit litigation.

At the end of December, Ukrainian prisoners of war and civilians arrested by the pro-Russian militants in Donbas returned to Ukraine, as agreed at the Normandy summit in Paris on December 9. Further exchanges of prisoners are expected in the future.

Verhovna Rada continue to work on the reform agenda. After a short winter break, MPs are introducing changes into the land market reform legislation. The Cabinet of Ministers passed to Rada the new liberal and progressive Labor Code.

### **Economic Growth**

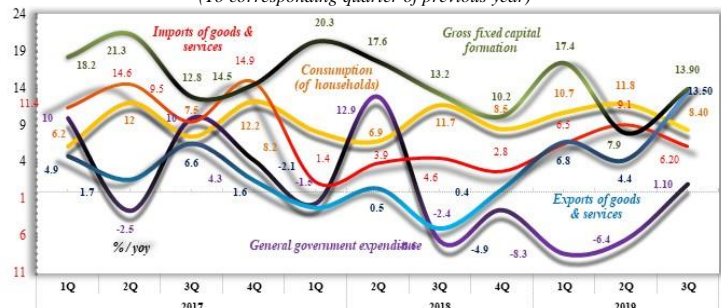
The State Statistics Service of Ukraine confirmed that Ukraine's GDP grew by 4.1% in the third quarter of 2019. On the expenditure side of GDP, this economic growth was driven by growth of household consumption (8.4%) and gross fixed capital formation (13.9%). In addition, foreign trade contributed with a reduction in its deficit, thanks to a higher exports growth of goods and services (13.5%), than imports expansion (6.2%).

On the production side of GDP, in the 3<sup>rd</sup> quarter of 2019 the mayor sources of GDP growth were construction activities (20.6%); other service activities (16.1%); information and communication (7.1%); administrative and support services (6.9%); real estate (6.8%); accommodation and food service (6.5%); agriculture, forestry and fishing (6%); professional, scientific and technical (5.4%); human health and social work (4.9%); repair of motor vehicles and motorcycles (4.3%); financial and insurance (4.2%); and transportation and storage (3.9%). On the other side, negative rate of GDP growth took place in manufacturing (-0.4%), electricity, gas, steam and air conditioning supply (-0.2%), and education (-0.5%).

The most recent data for November show that economic growth may have slowed down in the fourth quarter of 2019, which may lead to a GDP growth rate of 3.6% for 2019. In fact, in November 2019, Ukrainian's agricultural sector experienced a major output reduction of 18.5% yoy, comparing to the same month of the previous year. Similarly, Ukrainian industrial sector continued its weak performance of the previous months, with an output decline of 7.5% yoy, with manufacturing falling down by 6.4% yoy, and with declines in all

#### **GDP Growth of Ukraine, % yoy**

(To corresponding quarter of previous year)



Source: The Bleyzer Foundation

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sectors, except chemicals (34% yoy) and furniture machinery repairs growth (1.5% yoy). Subsector performance was as follows: metal products (-14.2% yoy); machinery & equipment (-12.7% yoy), textile industry, sewing of clothes, leather, leather articles (-8.6% yoy); wood products, paper and printing (-8.6% yoy); coke and refined petroleum products (-7.1% yoy); rubber and plastic products, other non-metallic mineral products (-6.1% yoy); foodstuffs, beverages and tobacco products (-4.7% yoy); basic pharmaceutical products (-1% yoy). Similar negative results were shown at mining of quarrying (-7.9% yoy), coal and lignite (-10.4% yoy), metal ores (-8.9% yoy) and extraction of crude petroleum with natural gas (-0.9% yoy), as well as electricity, gas, steam and air conditioning supply decline of 12% yoy. On the other hand, construction activities and retail trade continued to perform well in November, with growth rates of 18.1% yoy and 12.8% yoy, respectively.

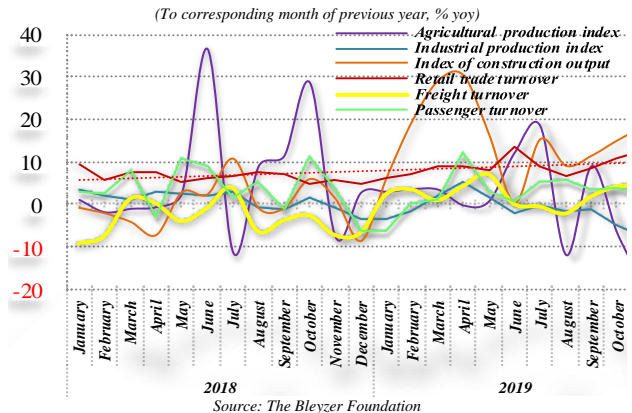
In terms of geographical distribution of industrial production, six oblasts enjoyed output growth, as follows: Odesa (19.5% yoy), Kirovohrad (8.8% yoy), Kherson (4.4% yoy), Kyiv (4.2% yoy), Vinnytsya (3.5% yoy), and Luhansk (1% yoy) in November 2019. Other regions had reduction of production, particularly at Zakarpattya (-30.5% yoy), Chernihiv (-22% yoy), Donetsk (-16.6% yoy), Zhytomyr (-15.8% yoy), Ternopil (-14.7% yoy), Volyn (-11.5% yoy), Kharkiv (-11.3% yoy), and Dnipropetrovsk (-9.1% yoy).

## Fiscal Policy

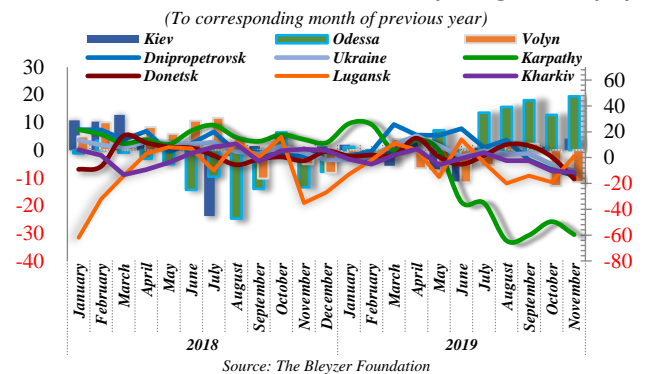
The **consolidated fiscal budget** was in deficit in November. The deficit of the state budget of UAH 4.6 billion was complemented by a deficit of local budgets of UAH 1.7 billion. The government was not very active in borrowings and debt repayments to execute the budget in November. Net borrowing amounted to just UAH 389 million. It was also not active on its liquidity regulation instruments. The government pumped UAH 5.4 billion to the economy which is almost three times less than in October. The cumulative consolidated budget deficit from the beginning of the year increased to UAH 6.8 billion in January-November. Taking into account better budget planning and the government's practice of cutting financing of not protected expenditures in case of slower than expected growth of revenues, we expect the consolidated budget deficit to be around 2.1% in 2019 and fall within the interval agreed with the IMF of up to 2% of GDP in 2020.

Growth of **consolidated budget revenues** turned negative in November. Total revenues dropped 4.4% yoy on the back of fast decline in non-tax revenues (50.1% yoy) caused by lower profit transfers to the state budget by Naftogaz. On the other hand, tax revenues grew by 3.1% yoy which was almost 6 times faster than in October. This was the result of good financial stance of companies and lower VAT reimbursements as compared to the previous month. Receipts from corporate profit tax grew much slower than in October but still at high rate of 18.9% yoy. Lower VAT reimbursements led to a 108.1% yoy increase in overall receipts from VAT on domestic goods and services. Receipts from personal income tax posted a 13.3% yoy increase. Growth of cumulative consolidated budget revenues from the beginning of the year further slowed to 8.3% yoy in January-November.

## Ukraine Economic Performance by Sector



## Ukraine Industrial Production by Region % yoy



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**Consolidated budget expenditures** grew at decelerated pace in November. Growth of total expenditures decreased to 7.3% yoy mainly because of the decline in debt servicing expenditures and faster decline in expenditures on goods and services. The former dropped 18.7% yoy after a 22.2% yoy growth in October, while the later declined by 8.0% yoy (4.7 percentage points faster than in the previous month).

In November Government payments on state and guaranteed debt denominated in foreign currency were almost at the same level as a month ago. The total amount of payments was USD 644.7 million equivalent. EUR 425.5 million were principal and servicing payments on domestic sovereign bonds and USD 9.2 million was paid on Eurobonds. The government and the NBU also paid USD 84.4 million to the IMF. The mentioned expenditures were partially offset by funds received from placement of domestic sovereign bonds denominated in foreign currency in amount of USD 304.9 million.

### Monetary Policy

**Inflation.** Consumer inflation sustained a significant drop in November. The all items index decreased by 1.4 percentage points to 5.1% yoy on the back of strict monetary policy and further hryvnia strengthening. Core inflation decelerated from 5.8% yoy to 4.8% yoy.

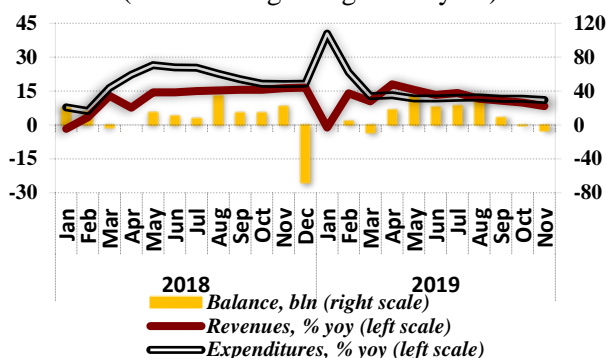
All major groups of goods and services sustained deceleration in price growth. Major reasons were increases in supply (like in the case of whole foodstuffs) and exchange rate dynamics which led to slower growth and even decline in prices of imported goods. Housing and utilities tariffs posted the largest deceleration in growth of 3.2 percentage points to 1.1% yoy despite an increase in prices of gas for population.

According to the preliminary data, consumer inflation was at 4.1% yoy in December. This is significantly below our expectations and the forecast of the NBU. Moreover, this level is below the medium-term target of 5% yoy. The reasons were restraining monetary policy, dynamics of the exchange rate, and restrictions on budget expenditures in December. The government planned the state budget for 2020 basing on the inflation level of 6% yoy.

**Banking Sector.** Banking deposits expanded at an accelerated pace in November. Growth of national currency deposits accelerated by 3.8 percentage points to 16.9% yoy, while that of the foreign currency deposits denominated in USD increased by 5.7 percentage points to 19.2% yoy. Accelerated growth in the two currency segments was the result of faster expansion in both business and household sectors. In particular, national currency deposits grew by 17.6% yoy in the business sector and by 18.1% yoy in the household sector. Foreign currency deposits denominated in USD increased by 37.2% yoy and 12.7% yoy, respectively.

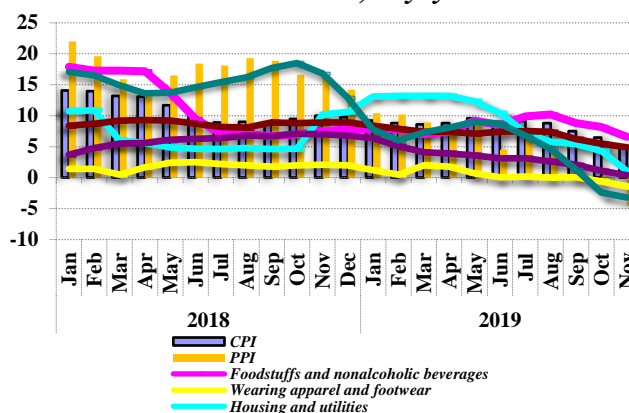
Bank lending posted another sluggish performance in November. High interest rates hindered both foreign

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



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

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



Source: State Statistical Service of Ukraine, The Bleyzer

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currency lending, while national currency lending grew at a low rate of 0.6% yoy for the second month in a row. Fast growth of consumer loans of 24.6% yoy once again more than offset a 7.0% yoy decline in corporate loans. Foreign currency loans denominated in USD dropped 11.2% yoy due to faster declines in both corporate and household loans (9.3% yoy and 24.6% yoy, respectively).

Taking into account slow inflation, we expect the NBU to lower the policy rate in 2020. This will lead to changes in dynamics of both deposits and loans. Growth of deposits will slow gradually, while loans will grow faster. In relation to loans, those changes will be more evident in the corporate sector. At the same time, in relation to deposits, the changes will be more evident in the household sector.

The monetary base expanded by 1.1% mom in November. However, its year-over-year growth slowed to 3.3%. At the same time, money supply remained unchanged in monthly terms but grew faster year-over-year at 8.4%.

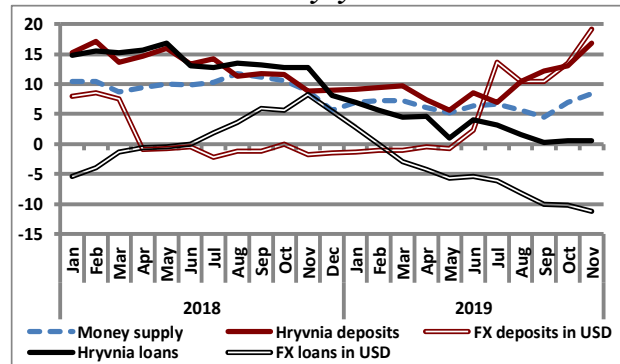
**Hryvnia Exchange Rate.** The official UAH/USD exchange rate was on the appreciatory trend the whole December. The major factors of appreciation remained the same – increased inflow of dollar from non-residents and exporters. However, there was also one additional factor. The government significantly decreased spending because of cash deficiencies, which resulted from lower than planned budget revenues. On the other hand, the government rapidly increased expenditures at the end of the month, including significant VAT reimbursements. This led to fast depreciation of the exchange rate quotation at the interbank forex market which was not supported by actual deals. As a result, the exchange rate depreciated significantly during the first trading sessions of 2020.

We expect further depreciation of the exchange rate to 26 UAH/USD by the end of 2020. We base our expectations on two factors. First, Ukraine has to make significant foreign currency payments of about USD 9 billion on external and domestic debt in 2020. And second, the NBU will be forced to lower the policy rate because of low inflation. This will lead to decline in profitability of domestic sovereign bonds denominated in hryvnia and will make them less attractive for non-residents. The first factor increases demand for foreign currency, mainly dollar, while the second one significantly lowers its supply. Remittances are not expected to grow fast enough to compensate for the effect from two mentioned factors, while foreign trade will remain in huge deficit. Therefore, we expect hryvnia to be under depreciatory pressures in 2020.

**International Trade and Capital**

In November 2019, Ukraine's current account had a surplus of USD 57 million, compared to a deficit of USD 116 million in November 2018. The major source of the current account surplus was a growth by 43.7% yoy (to USD 714 million) in net primary income, due to an increase in compensation of employees of 10.5% yoy to USD

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



Source: The NBU, The Bleyzer Foundation

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



Source: The NBU, The Bleyzer Foundation

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1,155 million in November 2019.

In November 2019 merchandise exports declined 3.4% yoy, comparing to the same month of previous year. Goods exports show improvements in the following sectors: chemical products (19.3% yoy), machinery and equipment (12.6% yoy), industrial products (8.9% yoy), and agricultural goods (0.8% yoy). Other sectors of exported goods had reductions, including mineral products (-19.3% yoy), timber and wood goods (-15.9% yoy), ferrous and nonferrous metals (-15% yoy) and informal trade (-9.2% yoy).

Regarding imports, merchandise imports had a reduction of 1.9% yoy, in November 2019. Declines in imports took place in mineral products (-27.5% yoy), timber and wood goods (-10.7% yoy), ferrous and nonferrous metals (-9.9% yoy) and chemicals goods (-6.2% yoy). The major source of growth for imported goods to Ukraine were from the following sectors: agricultural products (18.9% yoy), industrial goods (19.4% yoy), machinery and equipment (14.5% yoy) and other informal trade (1.2% yoy).

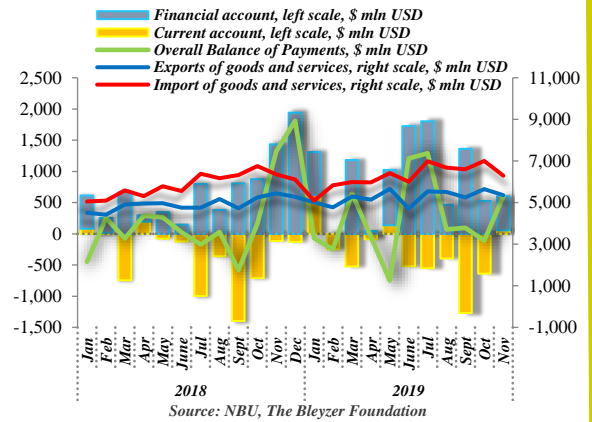
Ukrainian merchandise foreign trade deficit increased by 7.7% yoy to USD 12,556 million in January-November 2019. During this period, Ukraine deficit trade with CIS countries was reduced by 17% yoy, to USD 5,551 million (44.2% of the share). The deficit in trade with the Russian Federation fell down by USD 776 million to USD 3,799 million (30.3% of the share) in January-November 2019. At the same time, Ukrainian deficit with other countries increased by 13.1% to 55.8% of the total deficit amount.

In January-November 2019, the highest growth in merchandised export of Ukraine was with Africa (23.4% yoy), Asia (10.1% yoy), Australia (51% yoy), and EU countries (6.7% yoy). On the other side, reductions of goods export occurred with the USA (-12.4% yoy) and the Russian Federation (-12.2% yoy). At the same time, imports of products to Ukraine from CIS countries were reduced by 11% yoy and from United States they increased by 11% yoy.

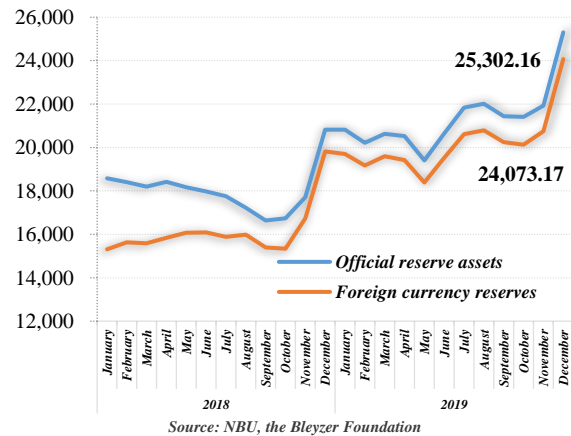
In November 2019, Ukrainian financial accounts inflows amounted to USD 544 million, compared to USD 1,434 million of November 2018. The major sources of financial account inflows were net foreign direct investments (FDI) with amounted to USD 436 million (37.5% yoy increase) in November 2019.

The overall consolidated balance of payments had surplus of USD 601 million in November. International reserves increased to USD 25,302 million, enough to finance 4 months of imports.

**Ukraine's External Balance of Payments**



**International Reserves of Ukraine**  
(Million USD)



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