

April 2018

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

Executive Summary

- ❖ On April 30, the Ukrainian authorities terminated the four-year old Anti-Terrorist Operation (ATO). It was replaced the Operations of the United Forces (OUF) which will be under the Defense Ministry of Ukraine and ultimately will report to the President of the Country. The OUF will be the main authority managing the military operations in Donetsk and Luhansk regions. The new status of operation emphasizes the military nature of the conflict and just not anti-terrorism as it was in the past.
- ❖ In April, the Cabinet of Ministers introduced a flat international-parity tariff for gas used by non-household consumers. Therefore, discretionary selectivity in gas tariffs for different groups of business consumers was fully eliminated.
- ❖ In March 2018, the Ukrainian economy continued its recovery, but at a slow and uneven pace. Ukraine's industrial production increased by 1% yoy, compared to the same month of previous year. Ukraine also experienced a growth rate of 7.6% yoy in retail trade turnover, and 3.3% yoy in passenger turnover. On the other hand, Ukrainian construction output continues to perform poorly, with a decline of -4.3% yoy, or twice the fall of -2.3% yoy in February 2018. Moreover, following an increase of 3.4% yoy in February, Ukrainian manufacturing output shrunk significantly by -4.6% yoy in March 2018.
- ❖ The state budget was executed with a deficit of UAH 18.9 billion in March 2018, due to faster increases in expenditures than in revenues. Local budgets, in turn, were executed with a surplus of UAH 0.7 billion. Therefore, the cumulative consolidated budget balance from the beginning of the year turned negative at UAH 3.0 billion.
- ❖ Consumer inflation declined slightly in February to 13.2% yoy.
- ❖ In the banking sector, both national and foreign currency deposits expanded in March 2018, though at a lower rate than in February. Lending activities of commercial banks showed mixed results, with expansion in Hryvnia lending but with negative growth in foreign exchange lending.
- ❖ The UAH/USD exchange rate remained stable in April, ending the month at around 26.2 UAH/USD.
- ❖ In March 2018, the current account of the balance-of-payments had a deficit of USD 763 million, compared to a deficit of USD 509 million in March 2017. The increase in the current account deficit was due to a higher deficit in Primary Income and despite the fact that the deficit in trade of goods and services (USD 619 million) had remained relatively stable. International reserves amounted to USD 18.2 billion.

| Main Macroeconomic Indicators | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018f |
|---|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| GDP, USD billion | 173 | 180 | 130 | 87 | 93.4 | 104 | 113 |
| Real GDP Growth, % yoy | 0.2 | 0.0 | -6.6 | -9.9 | 2.3 | 2.5 | 3.0 |
| Fiscal Balance (incl. Naftogaz/Pension Fund), % of GDP | -5.5 | -6.5 | -11.7 | -2.1 | -2.3 | -1.5 | -2.5 |
| Public Debt, External and Domestic, % of GDP | 36.6 | 40.4 | 69.4 | 79.1 | 81.2 | 78.5 | 78.0 |
| Consumer Inflation, eop, % yoy | -0.2 | 0.5 | 24.9 | 43.3 | 12.4 | 13.7 | 9.0 |
| NBU Key Policy Interest Rate, % eop | 7.5 | 6.5 | 14.5 | 17.0 | 16.7 | 16.4 | 17.0 |
| Hryvnia Exchange Rate per USD, eop | 8.1 | 8.2 | 15.8 | 24.0 | 27.1 | 28.1 | 29.0 |
| Current Account Balance, % of GDP | -8.3 | -9.2 | -3.5 | -0.2 | -3.8 | -3.7 | -3.5 |
| Merchandise Exports, USD billions | 64 | 59 | 51 | 35 | 34 | 40 | 43 |
| Merchandise Imports, USD billions | 86 | 81 | 58 | 39 | 40 | 49 | 52 |
| FDI, Net Annual Inflow, USD billion | 8.4 | 4.5 | 0.4 | 3.0 | 3.3 | 2.3 | 5.0 |
| International Reserves, USD billion | 24.5 | 20.4 | 7.5 | 13.3 | 15.5 | 18.8 | 21.0 |
| Public External Debt, USD billion | 32.1 | 31.7 | 34.9 | 42.6 | 42.5 | 47.0 | 52.0 |
| Private External Debt, USD billion | 102.3 | 110.3 | 91.2 | 76.0 | 69.9 | 67.0 | 72.0 |

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Political and Reform Developments

On April 30, the Ukrainian authorities terminated the four-year old Anti-Terrorist Operation (ATO). ATO started in 2014 immediately after Russian-backed separatists occupied parts of Luhansk and Donetsk. The status of ATO allowed it to take action in the region only after formal approval by the Security Service of Ukraine (SSU), which managed all actions in these regions.

In place of ATO, the government has established the Operations of the United Forces (OUF). The United Forces will be under the Armed Forces in the Defense Ministry of Ukraine and ultimately will report to the President of the Country. It will be led by Lieutenant General Serhiy Nayev. Under the new law “On Temporarily Occupied Territories and the Operation of the United Forces (OUF)”, the OUF will be the main authority managing the military operations in Donetsk and Luhansk regions, will have a clear structure of governance, will have command over certain military assets, and will operate in a united operation headquarter. It will command the involvement of all government agencies including military, SSU, and police. The new status of operation emphasizes the military nature of the conflict and just not anti-terrorism as it was in the past. This change of the status of military operations in Donetsk and Luhansk might also signal on preparation to the introduction of the UN peace keepers in the region. Previously, this initiative was presented by Ukrainian authorities in several international high-level gatherings.

Ukraine continues to enjoy significant support for its territorial integrity from its international partners. The possible arrangements for conflict resolution in the Eastern part of the country were in agenda of the latest G-7 foreign ministers’ meeting in Toronto in April. The meeting was attended by the Ukrainian Foreign Minister Klimkin. The Ukrainian Foreign Minister re-confirmed the country’s readiness to contain any Russian aggression and emphasized the role of G-7 in these efforts. The acting US Secretary of State John Sullivan emphasized that USA remains an important supporter of the Ukrainian peace initiatives. The State Department said that it “reaffirmed the United States’ ironclad support for the sovereignty and territorial integrity of Ukraine in the face of Russian aggression”. Moreover, as it was agreed last fall Ukraine has already received Javelin anti-tank missiles. This is a part of \$47 million US Congressional military aid package which includes the supply of 210 Javelin missiles and 37 launchers. Such support should increase the country’s defense capability.

There is wide agreement in Ukraine and its international partners that the implementation of the government reform agenda is as important as the fight for the occupied territories. Despite some slowdown in the reform process, the country has been making some steady progress in different areas. In particular, as an element of the fight against corruption, the government has eliminated some discrepancies in the energy pricing market. In April, despite significant resistance by many industrial firms, the Cabinet of Ministers introduced flat international-parity for gas tariffs used by non-household consumers. Therefore, selectivity in tariffs for different groups of business consumers, which existed until recently, was fully eliminated. Consequently, opportunities for corruption behavior in this area were dismissed.

However, further actions on gas pricing are required. As was agreed with the international institutions, gas tariffs for households should be also increased to market levels. Due to the start of the election campaign, such hikes in tariffs is politically difficult for the ruling coalition. At the same time, keeping tariffs at its current level is not feasible for the Ukrainian authorities since it might put at risk country’s future cooperation with IMF, EU and other international partners. This is unaffordable for the ruling coalition since it might lead to financial destabilization in the country and even steeper decreases in their political support. Therefore, it is very likely that gas tariff reforms would continue although at a slower pace than initially expected.

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

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Economic Growth

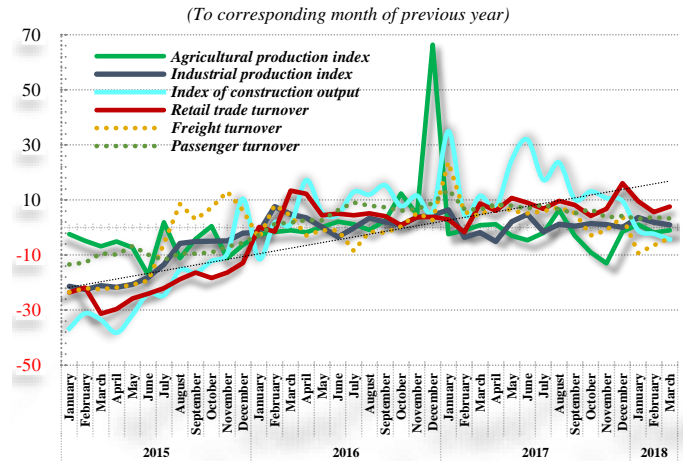
In March 2018, the Ukrainian economy continued its recovery, but at a slow and uneven pace. High frequency data showed that in March Ukraine's industrial production increased by 1% yoy, compared to the same month of previous year. The largest increase took place in mining of coal (15.3% yoy), metal ores (3.5% yoy) and quarrying (3.3% yoy), followed by electricity and gas supply (22.8% yoy).

In March 2018, Ukraine also experienced a growth rate of 7.6% yoy in retail trade turnover, compared to the same month of 2017. This expansion was supported by large increases in real and nominal average monthly wages, which raised by 9.5% yoy and 24.1% yoy in March 2018. Similarly, Ukraine passenger turnover had positive results, raising by 3.3% yoy, while freight turnover diminished its fall to -3.8% yoy, compared to -6.5% yoy reduction in February 2018. In addition, the agricultural sector of Ukraine also slowed down its decline to -1% yoy in March 2018, after bad weather had cut output by -1.8% yoy in February 2018.

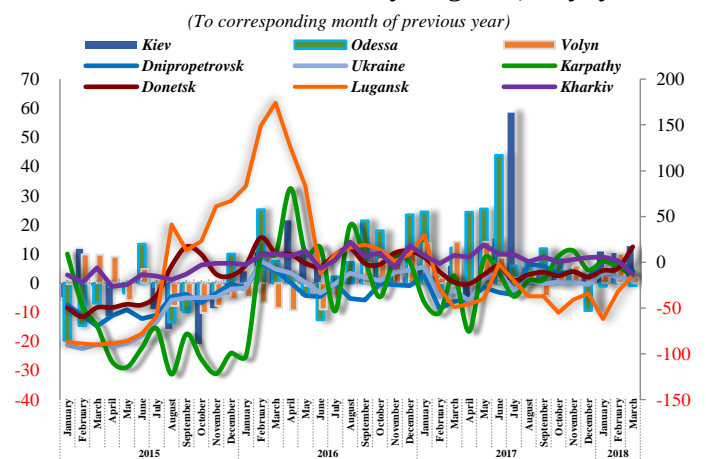
On the other hand, Ukrainian construction output continues to perform poorly, with a decline of -4.3% yoy, or twice the fall of -2.3% yoy in February 2018. Moreover, following an increase of 3.4% yoy in February, Ukrainian manufacturing output shrunk significantly by -4.6% yoy in March 2018. Within Ukraine's manufacturing production, the poorest ranged performances were as follows: furniture fell by -15% yoy; rubber, plastic and mineral products, by 14.7% yoy; food products, by -8% yoy; metallurgy, by -3.7% yoy; both industries of textile and pharmaceuticals products, by -3.1% yoy; and machinery and equipment output, by -2.8% yoy. Only three subsectors had positive growth of industrial activity in March, as follows: chemical products increased by 39.4% yoy; coke and refined petroleum products, by 15.4% yoy; and wood products, by 4.2% yoy.

On a geographical basis, in March 2018, most oblasts of Ukraine had negative rates of industrial growth, with the highest drops in the following regions: Mikolayiv (-17.2% yoy), Kirovohrad (-14.2% yoy), Kharkiv (-13.3% yoy), Zhytomyr (-10.4% yoy), Rivne (-9.6% yoy), Chernihiv (-6.2% yoy), and Kyiv city (-6.1% yoy). Positive results were shown in the following oblasts, as follows: Ivano-Frankivsk (23.7% yoy), Sumy (14.5% yoy), Kyiv (12.7% yoy), Cherkasy (6.5% yoy), Chernivtsi (6.1% yoy), Dnipropetrovsk and Zaporizhzhya both (3.9% yoy), Zakarpattia (2.4% yoy), and Volyn (2% yoy).

Ukraine Economic Performance by Sector, % yoy



Industrial Production by Regions, % yoy



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123 N. Post Oak Ln., Suite 410
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Fax: +38 (044) 284-1283
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Fiscal Policy

The state fiscal budget was executed with a significant deficit of UAH 18.9 billion in March due to faster increases in expenditures than in revenues. Local budgets, in turn, were executed with a small surplus of UAH 0.7 billion. Therefore, the cumulative consolidated fiscal budget balance from the beginning of the year turned negative at UAH 3.0 billion.

Growth of state budget revenues significantly accelerated in March. Acceleration to 31% yoy was mainly the result of the rapid growth in receipts from the enterprise profit tax (418.8% yoy) caused by changes in tax administering procedures and improved financial performance of businesses. High growth rate of receipts from individual income taxes (19.1% yoy) was caused by increases in nominal wages. Significant growth of nontax revenues (72% yoy) was the result of the inflow of the first tranche from sales of 4G licenses and transfer of net profits by state-owned enterprises. The cumulative consolidated budget revenues expanded by 12.9% yoy in January-March.

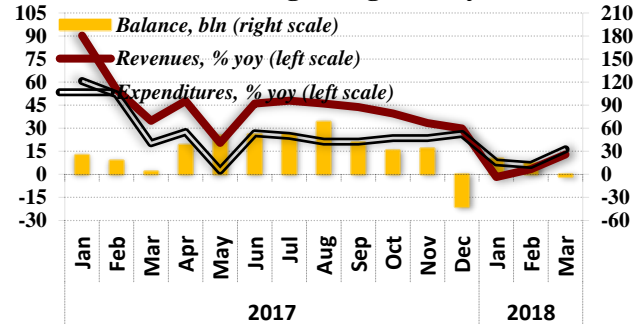
State budget expenditures in March grew at a higher rate than that of revenues. The 36.6% yoy growth was the result of much faster expansion of social security expenditures (103.3% yoy). In particular, there was a significant growth in transfers to the Pension Fund. Payroll and capital expenditures also grew at high rates (30.3% yoy and 94.5% yoy respectively). Growth of cumulative consolidated budget expenditures accelerated to 16.4% yoy in January-March.

In March, the Ukrainian government and the NBU paid USD 1,284.1 million of their external liabilities. This included USD 186.0 million paid to the IMF. The government paid USD 562.3 million interest payments on its eurobonds, while USD 678.8 million of both principal and interest payments were paid on sovereign bonds denominated in foreign currency. As reported before, Ukraine has to pay a total of USD 4.5 billion equivalent on its external debt in 2018.

Monetary Policy

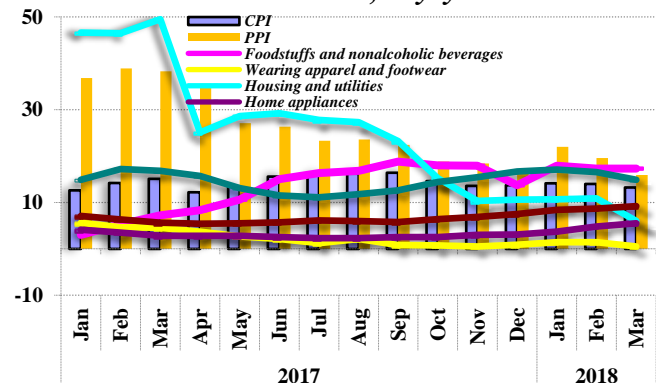
Inflation. Consumer inflation continued to decelerate in March but still remained slightly above expectations mainly due to faster growth of foodstuffs prices. Significant contribution to growth of prices was made by growth of production cost and fast recovery of consumer demand thanks to growth in population incomes. The all items index dropped 0.8 percentage points to 13.2% yoy, while core inflation decelerated to 9.4% yoy from 9.7% yoy observed in February. Prices of most of the major groups of goods and services sustained either small or no changes. Taking into account recent developments of prices, we leave our inflation forecast unchanged at 10% yoy in 2018.

Dynamics of consolidated 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 Foundation

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Banking Sector.

Both national and foreign currency deposits experienced some deceleration in growth in March. National currency deposits had a 3.6 percentage point deceleration of growth to 13.6% yoy. This was the result of deceleration in growth of household deposits by slightly more than 1 percentage point, which was significant enough to more than offset the two-fold acceleration in growth of corporate deposits to 9.4% yoy. A 1.0 percentage point deceleration in growth of the foreign currency deposits denominated in USD was due totally to the corporate sector, growth of deposits of which decelerated by almost three times to 2.5% yoy.

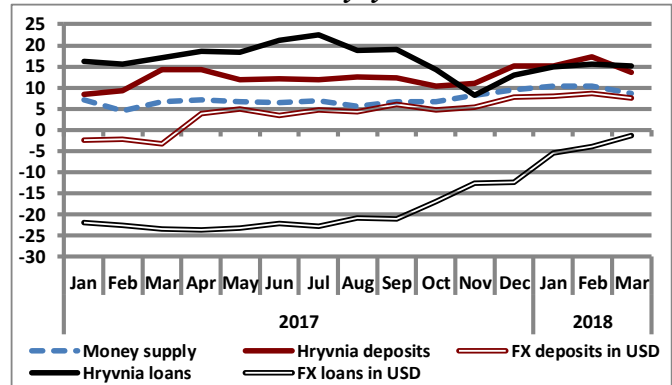
Bank lending activities sustained mixed developments in March. Growth of national currency loans slightly decelerated to 15.2% yoy, while the decline of foreign currency loans denominated in USD further decelerated reaching 1.3% yoy. Growth of national currency loans slightly decelerated because of a bit slower growth in both corporate and household loans. Deceleration in the decline of the foreign exchange loans denominated in USD happened thanks to change in dynamics of corporate lending (a 0.3% yoy decline turned into a 2.5% yoy growth).

The decline in balances at the correspondent accounts and almost flat cash resources were the reason of a 2.9% mom decrease in the monetary base, which led to deceleration in its year-over-year growth to 10.2%. At the same time, slower growth of hryvnia deposits and decline in foreign currency deposits denominated in hryvnia led to deceleration in the year-over-year growth of money supply to 8.7%.

Hryvnia Exchange Rate. The UAH/USD exchange rate saw little changes in April. Initially, there was some appreciation caused by deferred supply of dollar due to Catholic Easter celebrations. However, the exchange rate gradually depreciated by the end of the month returning exactly to the same level of around 26.2 UAH/USD.

The NBU improved the procedure of foreign exchange operations licensing for banks, population, and businesses, in line with its program of regulatory environment liberalization. In particular, the regulator simplified the procedure of issuing electronic foreign exchange operations licenses to private entities. It also allowed banks to place their foreign exchange assets into any their own accounts abroad without individual licenses. In addition, the NBU adopted a list of exceptions from the maximum interest rate on external foreign currency loans.

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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International Trade and Capital

In March 2018, the current account of the balance-of-payments had a deficit of USD 763 million, compared to a deficit of USD 509 million in March 2017. The increase in the current account deficit took place, despite the fact that the deficit in trade of goods and services (USD 619 million) had remained relatively stable, with a 2% mom, as compared to previous month, in February 2018 (17.2% yoy to March 2017). The deficit in the current account was principally due to a large deficit in the Primary Income account which increased by 82.3% yoy from USD 266 million in March 2017 to USD 485 million in March 2018.

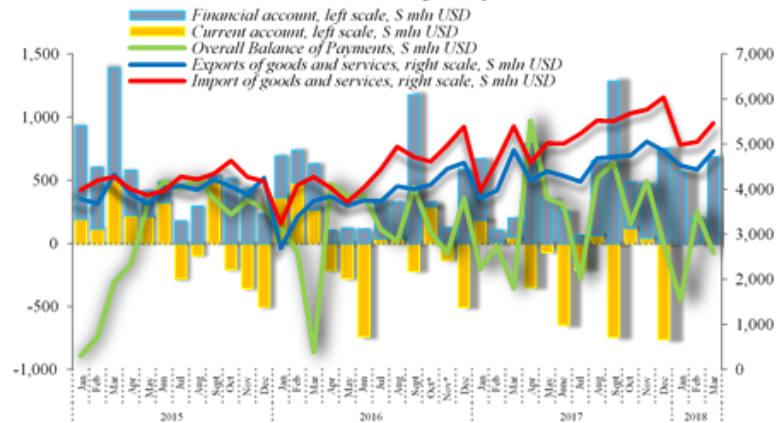
Ukrainian exports of goods amounted to USD 3,681 million in March 2018, a decrease of 4.1% yoy compared to March 2017. The major reduction in exports of goods took place in food products (by -16.2% yoy), informal trade (-34.1% yoy), and mineral products (by -3% yoy). On the other hand, Ukrainian exports increased in the following sectors: wood products (26% yoy), industrial goods (16.6% yoy), metallurgy (by 14.2% yoy), chemicals (by 10.7% yoy), and machinery (by 9.8% yoy). On a geographical basis, during the first three months of 2018, the highest increases in export of goods were to Europe (by 27% yoy) and America (by 13.3% yoy). In January-March 2018, EU's shares of the total exports expanded by 5.7% (from 34.1% to 39.8%), and American's export shares remained unchanged (from 2.9% to 3%). Exports to Russia decreased by 10.5% yoy, while its share in total exports declined from 8.3% in January-March 2017, to 6.8% in January-March 2018.

Ukrainian imports of goods increased by 0.7% yoy to USD 4,378 million in March 2018. The major import increases took place in food imports (15.8% yoy), wood products (13.8% yoy), metallurgy (13.1% yoy), and chemical products (6% yoy). At the same time, the main import reductions occurred in goods from informal trade (8.4% yoy), machinery and equipment (3.8% yoy), mineral products (by 5% yoy), and industrial goods (4.7% yoy).

The current account deficit of USD 763 million in March 2018 was partially financed by net inflows in the financial account of USD 686 million (compared to inflows of USD 153 million in March 2017). These inflows consisted principally of trade credits, which amounted to USD 422 million. FDI in March 2018 amounted only USD 105 million.

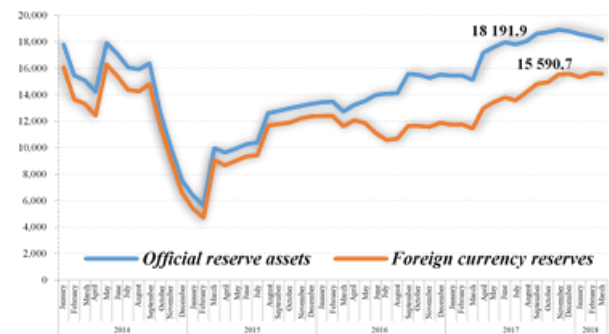
The overall deficit of the consolidated balance of payments amounted to USD 75 million in March, bringing the volume of international reserves down to USD 18.2 billion as of the beginning of April (4 months of imports).

Ukraine's External Balance of Payments, million USD



Source: NBU, The Bleyzer Foundation

Dynamic of Ukraine International Reserves, mln \$



Source: the NBU, the Bleyzer Foundation

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123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
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Kyiv 01004, Ukraine
Tel: +38 (044) 284-1289
Fax: +38 (044) 284-1283
Email: kiev.office@sigmableyzer.com.ua

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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