

July 2019

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Executive Summary

- ❖ The central topic in the Ukrainian current political landscape is the forthcoming parliamentary election scheduled for July 21st. The average of three recent polls show that the President's political party "Servant of the People" would be able to win around 43% of the votes among decided voters, based on its anti-corruption, pro-European stance. As only five to six political parties may be able to pass over the threshold of 5% of the votes, it is likely that the Presidential party may secure more than 50% of the seats in Parliament. This would permit the Rada to form rapidly a new Cabinet of Ministers and start the President's reform agenda.
- ❖ A revision of GDP growth in the first quarter of 2019 shows that the economy performed better than expected, with a GDP growth of 2.5%, compared to a previous estimate of 2.2% for the first quarter. For the year as a whole, GDP in 2019 is expected to grow at a rate of about 3.0% (compared to an earlier forecast of 2.8%), supported by lower energy prices, higher metallurgy prices, and higher agricultural output and exports.
- ❖ The consolidated budget was executed with a surplus for the second month in a row in May. As a result, the total cumulative budget surplus from January to May reached UAH 33.9 billion (2.2% of period GDP).
- ❖ Consumer inflation significantly accelerated in May 2019 to 9.6% yoy, due to higher prices for foodstuffs and transportation. At the same time, core inflation remained unchanged at 7.4% yoy.
- ❖ In the banking sector, national currency deposits expanded at a rate of 5.6% yoy. Bank lending activities were sluggish in May. National currency loans increased by 1.0% yoy, with household loans expanding by 27.5% yoy, while business loans declined by 5.9% yoy.
- ❖ The UAH/USD exchange rate was on the appreciatory trend in June reaching 26.1 UAH/USD by the end of the month. The major appreciation was the result of the sovereign bonds auctions held by the Ministry of Finance.
- ❖ In May 2019, the current account of the balance of payments had a surplus of USD 249 million, compared to a deficit of USD 79 million in May 2018. This improvement in the current account was supported by surpluses in the primary income account and by an improvement in the balance of good and services. However, this current account surplus was insufficient to cover net financial outflows of USD 1,004 million in May. As a result, international reserves declined to USD 19.4 billion by the beginning of June. Nevertheless, reserves recovered to USD 20.6 billion by the beginning of July.

| Main Macroeconomic Indicators | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019f |
|---|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| <i>GDP, USD billion</i> | 180 | 130 | 87 | 93.4 | 113 | 125 | 135 |
| <i>Real GDP Growth, % yoy</i> | 0.0 | -6.6 | -9.9 | 2.4 | 2.5 | 3.3 | 3.0 |
| <i>Fiscal Balance (incl. Naftogaz/Pension Fund), % of</i> | -6.5 | -11.7 | -2.1 | -2.3 | -1.4 | -1.9 | -2.3 |
| <i>Public Debt, External and Domestic, % of GDP</i> | 40.4 | 69.4 | 79.1 | 80.9 | 71.8 | 62.6 | 64.5 |
| <i>Consumer Inflation, eop, % yoy</i> | 0.5 | 24.9 | 43.3 | 12.4 | 13.7 | 9.8 | 8.0 |
| <i>NBU Key Policy Interest Rate, % eop</i> | 6.5 | 14.0 | 22.0 | 14.0 | 14.5 | 18.0 | 16.0 |
| <i>Hryvnia Exchange Rate per USD, eop</i> | 8.2 | 15.8 | 24.0 | 27.1 | 28.1 | 27.7 | 30.0 |
| <i>Current Account Balance, % of GDP</i> | -9.2 | -3.5 | 1.8 | -1.5 | -2.2 | -3.7 | -3.0 |
| <i>Merchandise Exports, USD billions</i> | 59 | 51 | 35 | 34 | 40 | 43 | 46 |
| <i>Merchandise Imports, USD billions</i> | 81 | 58 | 39 | 40 | 49 | 56 | 58 |
| <i>FDI, Net Annual Inflow, USD billion</i> | 4.5 | 0.4 | 3.0 | 3.3 | 2.3 | 2.4 | 2.0 |
| <i>International Reserves, USD billion</i> | 20.4 | 7.5 | 13.3 | 15.5 | 18.8 | 20.8 | 18.0 |
| <i>Public External Debt, USD billion</i> | 31.7 | 34.9 | 42.6 | 42.5 | 47.0 | 49.9 | 50.0 |
| <i>Private External Debt, USD billion</i> | 110.3 | 91.2 | 76.0 | 69.9 | 70.0 | 71.0 | 72.0 |

Political and Reform Developments

The central topic in the Ukrainian current political landscape is the forthcoming parliamentary election scheduled for July 21st. The average of three recent polls show that the President's political party "Servant of the People" would be able to win around 43% of the votes among decided voters, based on its anti-corruption, pro-European stance. The second largest fraction – the pro-Russian Opposition Block - is expected to win about 13% of the votes. Other political parties that should be able to overcome the five-percent threshold are the Poroshenko's European Solidarity party with 8% of the votes, and the party of Yulia Tymoshenko, which is close to 7% of the votes. In addition, a new party - Voice - established recently by singer Sviatoslav Vakarchuk may be able to get 5% of the votes, according to recent polls. Given margins of error in the polls, it is possible that one additional party may be able to reach the 5% threshold. According to these polls, these six political parties would be able to capture a total of 81% of decided voters. With 43% of this total, the President's party may be able to receive over 50% of the seats in Parliament. This Rada majority may enable the Presidential party to form a new Cabinet of Ministers rapidly and start expeditiously its reform agenda. This would remove current political uncertainties and support the revival of economic growth. The new Cabinet should be able to start its work at the end of August.

Since assuming office, President Zelenskiy has fired 20 out of 24 governors. Some of the new key governors have been appointed already. It is expected that within the course of the month all vacancies in the regions will be fulfilled. By these appointments, the President expects to have an effective influence in all the regions of the country.

Some positive developments have already been initiated in the areas of tax and customs administrations. Both institutions have been administratively separated, as was agreed with Ukraine's international partners as an important component of the reform agenda for the country. The results of competitions for the top management positions in both institutions have been announced. The State Customs Service will be headed by a respected reformist, Maksym Nefyodov, who helped introduce the ProZorro e-procurement system in the country. The President also said to the European Commission that the High Anti-Corruption Court will start hearing cases in September. He also indicated that he will handle expeditiously the conflict with Russia, starting with the first task of achieving a permanent ceasefire.

For the first time in its modern economic history, Ukraine held a Western-standards open competition for Production Sharing Agreements in the gas and oil sector. The results of the competition were announced in July. The execution of these agreements should allow Ukraine to increase significantly domestic production of energy resources. It should make Ukraine an energy independent country within a few years.

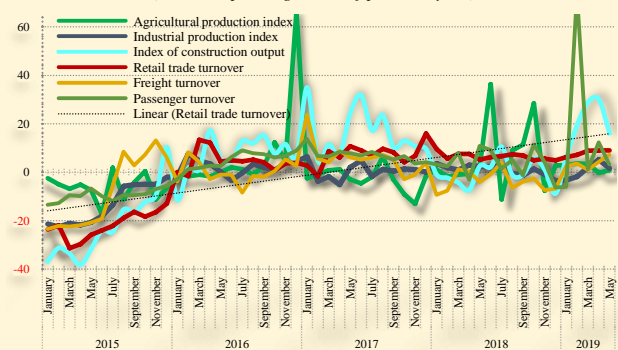
Economic Growth

A revision of GDP growth in the first quarter of 2019 shows that the economy performed better than expected, with a GDP growth of 2.5%, compared to a previous estimate of 2.2% for the first quarter. This is still a reduction in growth compared to the previous quarter and was caused principally by a slowdown in government consumption, driven by the need to repay government debt and control public finances as required by the IMF.

The latest monthly data confirm that the economy is gradually recovering, despite political uncertainties related to the elections. Economic growth has been supported by strong domestic demand stimulated by

Ukraine Economic Performance by Sector, % yoy

(To corresponding month of previous year)



Source: State Statistics Committee, The Bleyzer Foundation

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increases in real wages (7.0% yoy) and nominal wages (17.4% yoy) and by high transfers and workers remittances from abroad. These factors led to increases in domestic consumption and investments. In fact, in May 2019, retail trade increased by 8.2% yoy, construction activities expanded by 16.2% yoy, and freight transportation grew by 7.2% yoy.

In May, industrial production grew by a low rate of 1.6% yoy, compared to a high rate of 5.2% shown in April. The expansion in May was led by a recovery of mining, which grew by 4.6% yoy. Manufacturing was almost stagnant, with a growth rate of 0.7% in May.

Within manufacturing, the highest growth rates in May took place in food products (7.7% yoy), chemicals (6.7% yoy), metallurgy (6.5% yoy), furniture (3.5% yoy) and pharmaceuticals (3.4% yoy). On the other hand, the following manufacturing sectors experienced declines in production: textiles (-8.2% yoy), wood products (-5.1% yoy), rubber and plastics (-5.0%) and machinery and equipment (-5/0% yoy).

The regions that had the highest rates of growth in industrial output in May were Rivne (29.7% yoy), Vinnytsya (28.6% yoy), Sumy (24.6% yoy), Donetsk (15.0% yoy) and Ternopil (10.8% yoy). On the other hand, the Oblasts with the highest declines in output were Luhansk (-15% yoy), Zhytomyr (-14% yoy), and Khmelnytskyi (-7% yoy).

Despite political uncertainties, GDP in 2019 is expected to growth at a rate of about 3.0% (compared to earlier forecast of 2.8%), supported by lower energy prices, higher metallurgy prices, and higher agricultural output and exports.

Fiscal Policy

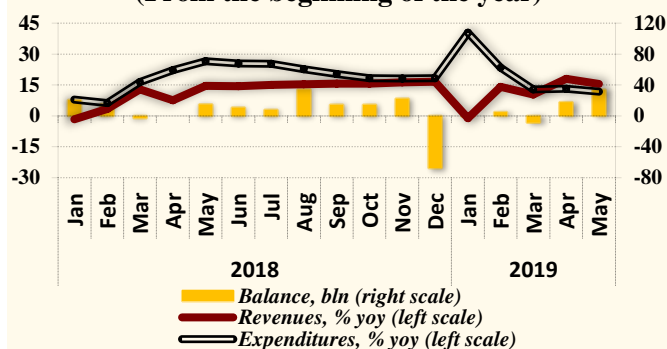
The consolidated budget was executed with a surplus for the second month in a row in May. The state budget surplus was at UAH 9.4 billion and local budgets had a cumulative surplus of UAH 6.8 billion. The government used the surplus mainly to repay loans previously assumed for budget execution purposes. Net repayments totaled UAH 25.4 billion. At the same time, the government extracted UAH 9.5 billion of cash from the economy. The total budget surplus of UAH 16.2 billion expanded the cumulative surplus from the beginning of the year to UAH 33.9 billion by the end of May (2.2% of period GDP).

Growth of consolidated budget revenues

decelerated in May. The 8.3% yoy growth of total revenues was caused solely by higher tax revenues, while non-tax revenues remained virtually unchanged. Receipts from personal income tax continued to grow at high rate of 19.3% yoy, while receipts from corporate profit tax declined by 5.4% yoy due to deteriorating financial results of businesses. Lower growth of imports negatively affected growth of receipts from excise taxes and VAT on imported goods (which decelerated to 4.4% yoy and 8.8% yoy respectively). At the same time, growth of receipts from excise taxes and VAT on domestic goods remained high at 33.8% yoy and 38.6% yoy, respectively. The highest growth rates were reported for local taxes and fees but the share of these taxes is too low to influence the overall dynamics of tax revenues. Cumulative consolidated budget revenues from the beginning of the year expanded at a rate of 15.5% yoy in January-May.

Same as with revenues, consolidated **budget expenditures** sustained some growth deceleration in May. However, the deceleration was less significant at 7.6% yoy. Deceleration was observed in both current and capital expenditures, although the later grew at a faster rate (8.3% yoy against 7.5% yoy). Current transfers

**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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posted the highest growth of 96.7% yoy. Growth of payroll expenditures remained high at 19.0% yoy, while that of state debt service expenditures significantly decelerated to just 3.7% yoy. Spending on goods and services posted decline of 1.7% yoy due to much lower spending at the local level. At the same time, social security expenditures decreased by 4.0% yoy because of lower spending on transfers to the Pension Fund. Growth of cumulative consolidated budget expenditures from the beginning of the year slowed to 11.8% yoy in January-May.

In May, loan principal and service payments on the state and guaranteed debt denominated in foreign currency more than doubled as compared to those in April. In particular, principal and servicing payments on Eurobonds and domestic sovereign bonds amounted to USD 1,281 million. Also the government and the NBU paid USD 446 million equivalent to the IMF. Taking into account payments to other IFIs, total payments on state and guaranteed debt totaled USD 1,801 million equivalent in May.

Monetary Policy

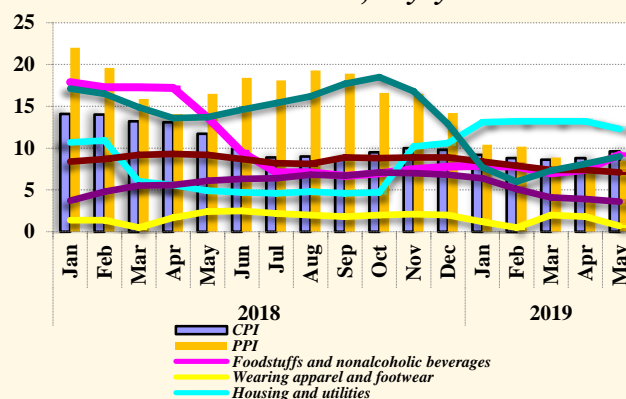
Inflation. Consumer inflation significantly accelerated in May. This was expected as lower supply of foodstuffs led to faster growth of their prices, while difficulties with imports of energy resources from Belarus and Russia caused an increase in prices of fuels. The all items index increased to 9.6% yoy. At the same time, core inflation remained unchanged at 7.4% yoy.

Accelerated growth in consumer inflation was the result of faster price increases in two major groups of goods and services. Prices of foodstuffs saw their growth accelerating by 1.8 percentage points to 9.2% yoy, while growth in transport prices accelerated by 0.9 percentage points to 9.0% yoy. Prices of most other major groups of goods and services grew at decelerated rates, most notably for wearing apparel and footwear (by 1.1 percentage points to 0.7% yoy), housing and utilities (by 0.9 percentage points to 12.3% yoy), communication services (by 0.7 percentage points to 16.6% yoy), and alcoholic and tobacco products (by 0.6 percentage points to 16.4% yoy). Other major groups of goods and services saw little changes in price growth (not exceeding 0.3 percentage points).

Considering stable core inflation and upcoming harvesting period, we leave our forecast for inflation unchanged at 8.0% yoy at the end of the year.

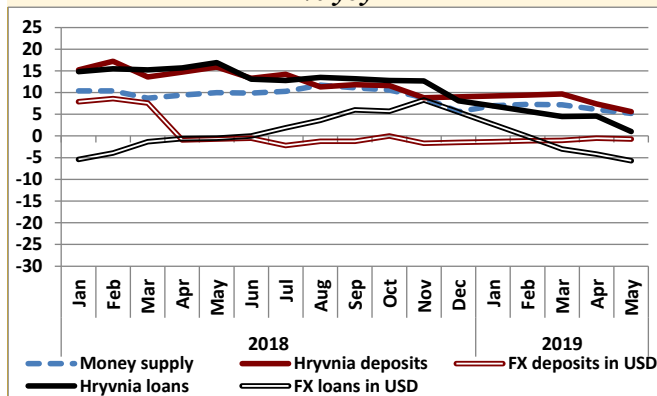
Banking Sector. As expected, banking deposits posted mostly negative developments in May. Many holidays and day-offs during the month led to lower growth of national currency deposits of households and businesses (11.4% yoy and 1.6% yoy respectively). Overall, national currency deposits expanded at a decelerated rate of 5.6% yoy. The decline of the foreign currency deposits denominated in USD remained virtually unchanged at 0.7% yoy as accelerated decline in deposits of the corporate sector (to 4.9% yoy) was almost fully offset by accelerated growth in deposits of

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



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

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



Source: The NBU, The Bleyzer Foundation

population (at 2.6% yoy).

Bank lending activities were sluggish in May. National currency loans inched up just by 1.0% yoy on the back of expanding consumer loans, ensuring growth of total household loans by 27.5% yoy. At the same time, business loans declined by 5.9% yoy. Total foreign currency loans denominated in USD posted an accelerated decline of 5.7% yoy due to faster declines in both corporate and household sectors (by 4.0% yoy and 15.4% yoy, respectively).

It is important to mention that statistical data on both deposits and loans was negatively affected by liquidation of a relatively big bank in May.

Growth of both monetary base and money supply decelerated in May. Monetary base expanded by 5.3% yoy, while money supply grew at slightly lower rate of 5.2% yoy.

Hryvnia Exchange Rate. The UAH/USD exchange rate was on the appreciatory trend in June reaching 26.1 UAH/USD by the end of the month. The major appreciation happened at the beginning of the month and was the result of the sovereign bonds auction held by the Ministry of Finance. The high profitability of bonds denominated in Hryvnia attracted many non-residents bringing foreign exchange to the country. Regular sovereign bonds auctions and additional amounts of foreign currency from agricultural producers supported further appreciation of the exchange rate until the end of the month, although at rather slow pace, despite the decision of the NBU to lift obligatory sale of foreign currency revenues at the interbank forex market starting on June 20th.

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



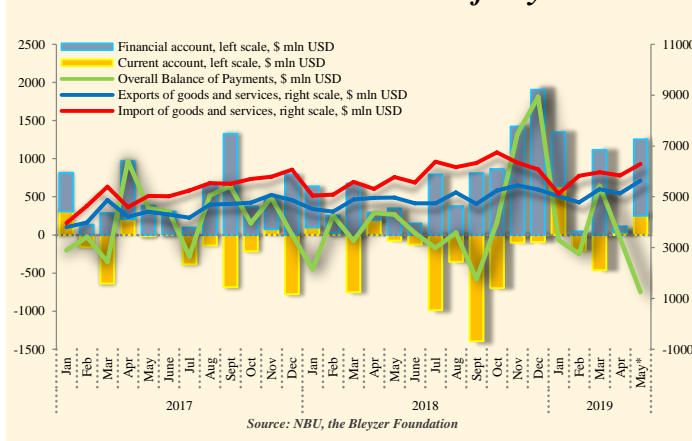
Source: The NBU. The Blevzer Foundation

International Trade and Capital

In May 2019, the current account of the balance of payments had a surplus of USD 249 million, compared to a deficit of USD 79 million in May 2018. The surplus in the current account was due principally to an improvement in the primary income account (in particular net compensation of employees), which grew by 56% yoy and had a surplus of USD 624 million in May.

This improvement in the current account was also supported by an improvement in the balance of good and services, whose deficit was reduced from USD 806 million in May 2018 to USD 648 in May 2019. In May 2019, exports of goods increased by 13.9% yoy (to USD 4,156 million), a larger increase than the 8.0% increase in imports of goods (which amounted to USD 4,976 million in May 2019).

Ukraine's External Balance of Payments



Source: NBU, the Blevzer Foundation

Agricultural products continue to be the largest export category, with exports of USD 1,836 million in May 2019 (representing 44% of total exports and with a growth rate of 34.1% yoy). Metallurgical exports represent the second largest export group with a share of 24% of exports (amounting to USD 1,007 million in May), but had

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7.1% yoy decline compared to May 2018. The third largest export category was exports of mineral products, which amounted to USD 467 million in May 2019, an increase of 41% yoy.

From a geographical point-of-view, in January-May 2019 Ukraine exports to Russia continued to decrease, falling by 16.0% yoy and amounted to USD 1,065 million. They now represent only 5.6% of total exports. Exports to Europe continue to show high growth rates, increasing by 10.9% yoy in January-May 2019, and now account for 38.7% of total exports. Exports to Asia increased by 7.1% yoy in January-May, representing 31.7% of total Ukrainian exports. Exports to Africa are also growing fast at a rate of 24.8% yoy and amounted to USD 2,248 million in January-May 2019.

With regard to merchandise imports, in May 2019, machinery and equipment accounted for the major import share (30.9% of total imports, or USD 1,540 million). The second largest imports category was mineral products (including energy), which accounted for 23.6% of the total imports (or USD 1,176 million), increasing by 24% yoy. Imports of chemical products are the third largest import category, amounting to USD 925 million (18.7% of the total). Agricultural imports represent the fourth largest import group (with 8.2% of the total, at USD 413 million) and increased by 15% yoy in January-May.

Geographically, Europe is the largest supplier of goods to Ukraine, with a 41.5% share of imports in January-May 2019. It was followed by Asia with a 23.5% share. On the other hand, the share of Russia in Ukrainian imports has been reduced to 13.1% of the total, compared to 14.9% in January-May 2018.

In May 2019, the financial account had net outflows of USD 1,004 million. The largest foreign exchange outflows were due to net short-term loan repayments by the government (about USD 772 million) in May. Foreign direct investments amounted to only USD 70 million in May 2019.

The current account surplus of USD 249 million was not sufficient to cover net financial outflows of USD 1,004 million. As a result, the overall balance of payments had a deficit of USD 750 million, causing a drop in international reserves to about USD 19.4 billion as of the beginning of June. However, the NBU has reported that according to preliminary data, international reserves increased to USD 20.6 billion at the beginning of July.

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