

November 2018

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

Executive Summary

- ❖ On 23 November, the Parliament approved the 2019 budget with a fiscal deficit of 2.3% of GDP, a critical step to allow Ukraine to receive USD 3.9 billion in IMF financing. This will help stabilize the economy in 2019.
- ❖ On November 26, Verhovna Rada imposed Martial Law for 30 days in 10 oblasts bordering Russia, Transnistria, and the Azov Sea. This law was a reaction on the attack undertaken by Russian Federal Security Border agents against three Ukrainian military vessels approaching the Kerch Strait. The international reaction against Russian actions was fast and strong.
- ❖ Monthly data show that the economy continued to recover in October 2018. In fact, agriculture output increased by 28.5% yoy, following a rate of growth of 11.4% yoy in September. Other sectors also performed well in October, with construction output increasing by 5.8% yoy, retail trade expanding by 5.0% yoy, and passenger transportation turnover expanding by 3.4% yoy. Ukrainian industrial production output also recovered in October 2018, with a growth rate of 1.4% yoy, following a decline of 1.3% yoy in September.
- ❖ The consolidated fiscal budget was almost balanced in October. The state budget surplus of UAH 1.2 billion almost fully covered the deficit of local budgets of UAH 1.3 billion. The cumulative year-to-date consolidated budget balance remained positive and almost unchanged as compared to that in September at UAH 14.4 billion.
- ❖ After three months of stability, consumer inflation accelerated in October. The all items index increased by 0.6 percentage points to 9.5% yoy on the back of production cost growth and expanding consumer demand.
- ❖ In the banking sector, both deposits and lending activities continued to show improvements in October. Hryvnia deposits expanded by 11.8% yoy, while Hryvnia loans increased by 12.8% yoy.
- ❖ In the second half of November, the exchange rate depreciated due to Russia's aggression in the Azov Sea. But the exchange rate returned to about 27.9 UAH/USD by mid-December.
- ❖ In October 2018, the current account of the balance of payments had a deficit of USD 863 million, significantly lower than the deficit of USD 1.6 billion incurred in September 2018. Net financial inflows of USD 1.0 billion (principally from private sector operations) financed the entire CA deficit. International reserves amounted to USD 16.7 billion at the beginning of November.

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	3.2
<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	10.0
<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	-1.5	-2.2	-3.5
<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	17.0
<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

November 2018

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

Political and Reform Developments

On November 23, the Parliament approved the 2019 budget with a fiscal deficit of 2.3% of GDP, a critical step to allow Ukraine to receive USD 3.9 billion in IMF financing. This will help stabilize the economy in 2019.

On November 26, Verhovna Rada imposed Martial Law in 10 oblasts bordering Russia, Transnistria, and the Azov Sea. This law was a reaction on the attack undertaken by Russian Federal Security Border agents against three Ukrainian military vessels approaching the Kerch Strait. The crew members of the Ukrainian vessels were arrested for two months. According to Geneva Convention, all arrested Ukrainians are considered as prisoners of war. Therefore, they could not be a subject of the Russian criminal law investigation as Moscow tries to pretend. This view is supported by international community, including EU and the US.

International reaction on Russian actions in the Kerch Strait was fast and strong. German Chancellor Angela Merkel put the blame for the recent naval confrontation squarely on Moscow. The Chancellor stated very clearly that this was "entirely the doing" of President Putin. President Trump canceled his meeting with President Putin set for December 1st during the G-20 gathering in Argentina.

Despite national security reasons, martial law may negatively affect both (i) the general population and (ii) businesses. During its period of functioning, the law will restrict civic and political rights of citizens. However, the authorities assured that this would be applied only in case of Russian ground aggression. The implication for businesses is based on a downshift of confidence due to increased uncertainties. In particular, some reaction was noted in the exchange rate, which depreciated by around 2% during the first week after the attack. However, this negative affect was temporary with the exchange rate regaining its value. It is considered unlikely that Russia will try to invade Ukraine, since the Ukrainian army and the support from the West are now much stronger.

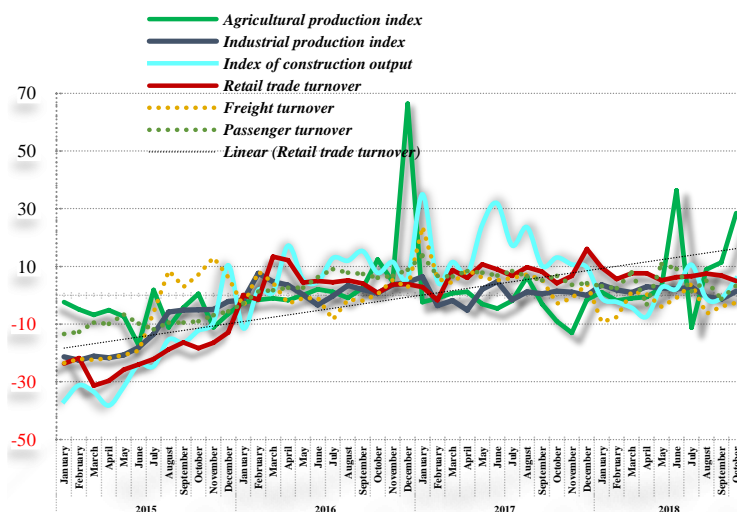
Although the official Presidential election campaign starts at the end of December, all major candidates are already campaigning. Different polls are led by Yulia Tymoshenko, but the results of the elections are still quite uncertain as about 60% of the voters are still undecided.

Economic Growth

High frequency monthly data show that the economy continued to recover in October 2018. In fact, agriculture output increased by 28.5% yoy in October 2018, following a rate of growth of 11.4% yoy in September. The construction sector also performed well, with construction output growth of 5.8% yoy in October. Furthermore, retail trade and passenger transportation turnover expanded by 5% yoy and 3.4% yoy, respectively. Freight transportation turnover, however, declined by 2.6% yoy. Economic growth was supported by significant increases in Ukrainian average salaries during the month (25% yoy in nominal, and 14.2% yoy in real terms.) These results took place despite the negative effects of a surge in inflation in October, due to higher consumer (9.5% yoy)

Ukraine Economic Performance, % yoy

(To corresponding month of previous year)



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

November 2018

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

and industrial (16.6% yoy) prices, as well as wages and salaries arrears (17.3% yoy).

Ukrainian industrial production output also recovered in October 2018, with a growth rate of 1.4% yoy, following a decline of 1.3% yoy in September. This industrial growth was supported by a recovery in manufacturing output and strong growth in mining. On the other hand, output of electricity, gas and air conditioning declined.

Within the manufacturing sub-sector, furniture and other repair products had the best performance with a growth rate of 12.2% yoy, followed by pharmaceutical goods, with a growth of 12.1% yoy, by refined petroleum & coke products (5.4% yoy), and by rubber and plastic products (5% yoy). On the other hand, the poorest results were in the manufacturing of textile products (-5.9% yoy), wood goods (-2.3% yoy), chemical products (-1.8% yoy), metals (-1.2% yoy), foodstuffs (-0.3% yoy) and engineering (-0.3% yoy).

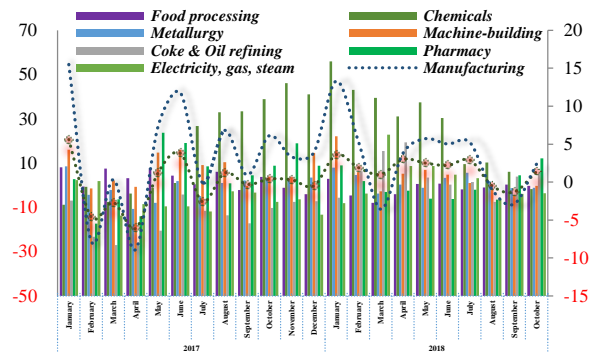
On a geographical basis, in October 2018, the regions with positive rates of growth in industrial output were as follows, ranked by performance: Luhansk (16% yoy), Sumy (15.2% yoy), Mikolayiv (10.8% yoy), Vinnytsya (9.9% yoy), Rivne (8.8% yoy), Ivano-Frankivsk (7.4% yoy), Ternopil (7.1% yoy), Odessa (6.4% yoy), Chernivtsi (5.8% yoy), Zakarpattya (5.6% yoy), Kharkiv (5.2% yoy), Lviv (4.7% yoy), Kherson (4.7% yoy), Poltava (3.3% yoy), Cherkasy (2.8% yoy), Kirovohrad (2.3% yoy), and Kyiv city (2.3% yoy). Negative rates of industrial output during October were experienced in the following oblasts: Zaporizhzhya (-3.1% yoy), Zhytomyr (-2% yoy), Dnipropetrovsk (-1.8% yoy), Volyn (-1.2% yoy), Chernihiv (-1.2% yoy).

Fiscal Policy

The consolidated fiscal budget was almost balanced in October. The state budget surplus of UAH 1.2 billion almost fully covered the deficit of local budgets of UAH 1.3 billion. The cumulative year-to-date consolidated budget balance remained positive and almost unchanged as compared to that in September at UAH 14.4 billion.

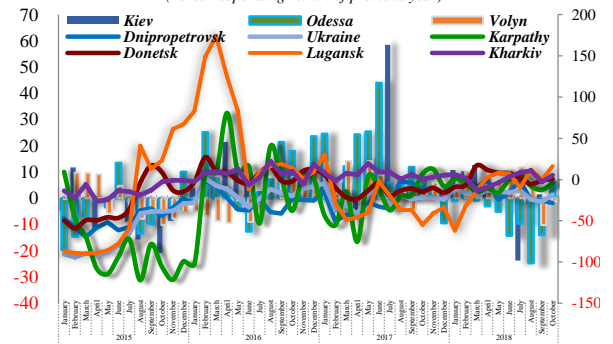
Although a bit lower than a month ago, growth of the consolidated budget revenues remained high in October. The total growth of 15.2% yoy was achieved solely thanks to a 22.5% yoy expansion of tax revenues, as non-tax revenues declined by 28.4%

Industrial Production by Sectors, % yoy
(To corresponding month of previous year)



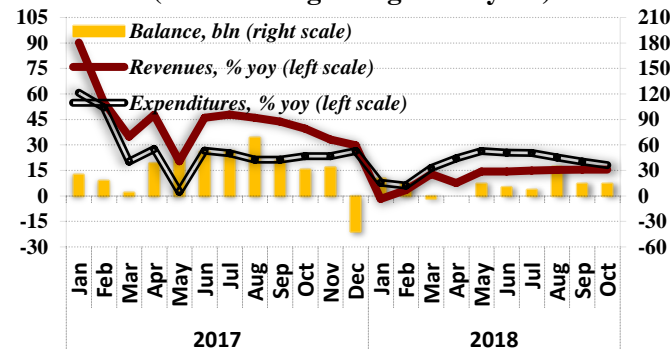
Source: State Statistics Committee, the Bleyzer Foundation

Industrial Production by Region, % 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

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: kyiv.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

November 2018

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

yoy due to shifts in transfers from the NBU. High rates of growth among tax revenues were reported for receipts from personal income taxes (24.0% yoy), the VAT (28.4% yoy), import duties (20.8% yoy), and single tax (19.0% yoy). However, royalties saw the fastest growth at 162.7% yoy because of diminished effect of high comparison base and new royalties administering rules. Excise tax receipts posted a 1.2% yoy decline driven by decrease in receipts from tax on imported goods and on goods sold at the retail market. Growth of cumulative consolidated budget revenues remained unchanged at 15.6% yoy in January-October 2018.

Growth of consolidated budget expenditures remained moderate in October. Total growth slowed to 2.8% yoy from 5.9% yoy observed a month ago. The lower growth rate was the result of declines in expenditures on state debt servicing and in social security expenditures. The former declined by 52.0% yoy thanks to restructuring of the domestic sovereign bond portfolio of the NBU last year. The latter declined by 20.0% yoy thanks to statistical base effect, as transfers of the Pension Fund had significantly expanded in October 2017 because of increases in pensions. Other major expenditure lines, except for healthcare, posted significant increases, ranging from 13.1% yoy for environment protection expenditures to 59.4% yoy for housing and utilities sector expenditures. Healthcare expenditures grew by 5.6% yoy. Growth of cumulative consolidated budget expenditures further decelerated to 18.2% yoy in January-October.

The government spent USD 853.0 million equivalent on principal and servicing payments on state and guaranteed debt denominated in foreign currency. USD 777.8 million was spent on repayment and servicing of domestic sovereign bonds.

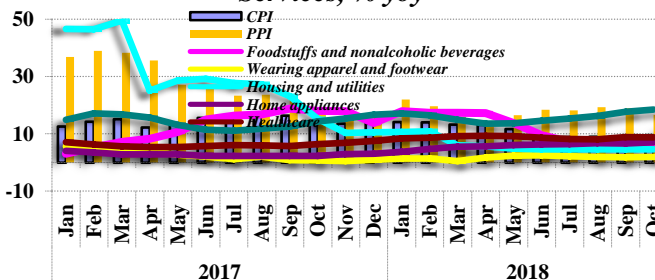
Monetary Policy

Inflation. After three months of stability, consumer inflation accelerated in October. The all-items index increased by 0.6 percentage points to 9.5% yoy on the back of higher production costs and expanding consumer demand. The pressure of world energy and crop prices on domestic prices also increased. Core inflation saw little changes remaining at 8.8% yoy.

Most of the major groups of goods and services observed minor but upwards changes in prices in October. The most significant acceleration in price growth rates was reported for communication services (by 2.7 percentage points to 13.6% yoy), alcoholic and tobacco products (by 1.2 percentage points to 16.9% yoy), and transport services (by 0.8 percentage points to 18.5% yoy). Healthcare and recreation and culture were the only two major groups reporting some slowing down of growth in prices. However, the slowing down was insignificant at 0.1 percentage points in both groups to 8.8% yoy and 4.6% yoy, respectively.

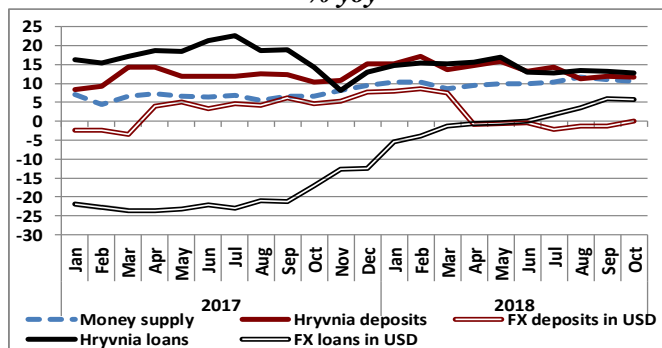
The dynamics of consumer prices coincided with our expectations in October. Therefore, we decided to leave our forecast for inflation unchanged at 10.0% yoy for 2018.

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

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: kyiv.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

November 2018

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

Banking Sector. In October, bank deposits continued to improve. The rate of growth of national currency deposits remained almost unchanged at 11.6% yoy, while growth of foreign currency deposits denominated in USD turned zero as compared to -1.2% yoy in September. Household and corporate national currency deposits saw growth rates of 19.3% yoy and 3.9% yoy, respectively. At the same time, the decline of corporate foreign currency deposits denominated in USD decelerated by almost four times to 1.1 % yoy, while growth of the correspondent household deposits slowed by 0.5 percentage points to 2.9% yoy.

Bank lending activities also showed improvements. Growth of national currency loans remained high at 12.8% yoy, while growth of foreign currency loans denominated in USD was more moderate at 5.7% yoy. Both household and corporate national currency loans posted growth rates of 43.0% yoy and 6.4% yoy, respectively. As for the growth dynamics of foreign currency loans denominated in USD, household and corporate sectors saw opposite trends. The decline of household loans slightly decelerated to 8.2% yoy, while corporate sector reported some deceleration in growth to 8.8% yoy.

The monetary base remained almost unchanged on a month-over-month basis in October, but experienced some deceleration in year-over-year terms by 0.7 percentage points to 12.9% yoy. Money supply, on the other hand, decreased by 0.3% mom as decline in banking deposits more than offset growth in cash resources outside banks. The year-over-year growth of money supply decelerated by 0.5 percentage points to 10.6% yoy.

Hryvnia Exchange Rate. As the State Treasury ceased VAT reimbursements to exporters and non-residents, they were not active at dollar purchases for dividend repatriation purposes. The UAH/USD exchange rate entered the appreciatory trend already at the beginning of November. The appreciating trend lasted until November 24th and was terminated by the escalation of conflicts with Russia in the Azov Sea and promulgation of martial law in Eastern and Southern regions of Ukraine. In the following week, the exchange rate reached 28.4 UAH/USD. But this depreciation trend was temporary, with the exchange rate reversing the trend once again on November 29th, reaching 27.9 UAH/USD by mid-December.

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



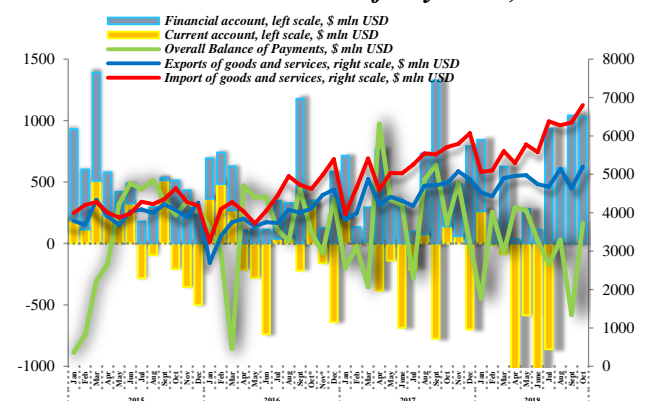
Source: The NBU, The Bleyzer Foundation

International Trade and Capital

In October 2018, the Ukrainian current account of the balance of payments had a deficit of USD 863 million, significantly lower than the deficit of USD 1.6 billion incurred in September 2018. The cumulative deficit from January to October 2018 reached USD 4.6 billion, or about 4.4% of period GDP. The October current account deficit was covered by net financial account inflows of USD 1.0 billion, principally due to inflows in private sector operations. International reserves remained flat at about USD 16.7 billion by the beginning of November 2018.

The improvement in the current account in October was due principally to lower interest rate payments, with the Primary Income balance improving from a deficit of

Ukraine's External Balance of Payments, 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

November 2018

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

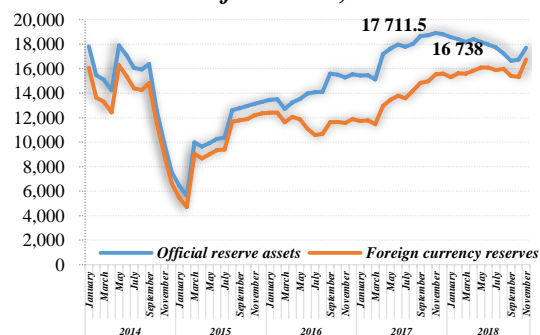
USD 218 million in September to a surplus of USD 449 million in October. Trade in goods and services also grew. On a year-over-year basis, in October Ukrainian exports of goods and services increased by 9% yoy, to USD 5.2 billion, while imports of goods and services grew by 19.3% yoy to USD 6.8 billion.

In October 2018, the major improvements in merchandise exports were in chemicals products (22.5% yoy), followed by agricultural products (15.8% yoy), machinery and equipment (11.9% yoy), mineral products (11.4% yoy), industrial goods (10.8% yoy), timber and wood products (6.3% yoy), and metals with other informal trade goods (3.2% yoy). On the other hand, large growth in Ukrainian imports occurred in machinery and equipment (34% yoy), industrial goods (34% yoy), ferrous & nonferrous metals (32% yoy), mineral products (22% yoy), agricultural products (21 % yoy), timber and wood products (12% yoy), chemicals (10% yoy) and informal trade 3.5% yoy in October 2018.

Regarding the regional destination of exports, in January-October 2018, exports to Russia decreased by 8.8% yoy, and now account for 7.2% of the total Ukrainian exports of goods, compared to 8.6% a year ago. On the other hand, Ukraine's exports to Europe grew by 16.6% yoy, and now represent 38.1% of the total export amount, compared to 36% in January–October 2017. Asia's share in total exports declined by 0.8% yoy (principally to Asia's CIS countries following Russian pressures) and now amount to 31.7% of the total amount. On the other hand, the share of imports from CIS countries to Ukraine continued to grow by 18.3% yoy (25.6% of the total imports amount), while other countries merchandised import increased by 15.2% yoy (74.4% of the total imports), in Jan-October 2018. At the same time, import from Russian Federation to Ukraine grew by 20% yoy and reached 14.3% of the total import amount, while Europe imports to Ukraine grew by 12.1% yoy with 40.2% shares of the total import's amount.

In October 2018, net inflows in the Ukrainian financial account grew by 170% yoy to USD 1.0 billion, compared to inflows of USD 370 million in the same month of the previous year. In addition, net inflows of foreign direct investment grew to USD 203 million. There was also a net reduction in “currency & deposits” of banking assets (USD 245 million), as well as growth of the real sectors net external debt of trade credit (USD 632 million). Long and short-terms loans increased by USD 148 million & USD 6 million, respectively.

International Reserve of Ukraine, mln USD



Source: NBU, The Bleyzer Foundation

As a result, the overall consolidated balance-of-payments surplus grew by 6% yoy to USD 164 million, compared to USD \$ 155 million in October 2017. Therefore, Ukrainian international reserves accumulated to USD 16.7 billion, which is enough for 2.9 months of future import requirements.

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