

August 2018

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### Executive Summary

- ❖ On September 6th, an IMF mission started its work in Kyiv to assess the current status of the program. It is expected that the main actions that Ukraine will need to implement in order to unblock cooperation with the Fund are increases in gas tariffs for households to international parity level, acceleration of the privatization program, and agreement on a sustainable fiscal budget, including pension reform.
- ❖ In the second quarter of 2018, GDP expanded by 3.6% yoy, compared to 3.1% yoy in the first quarter of the year. This growth rate was the highest rate achieved since 2016. Monthly data for July indicate that the Ukrainian economy has continued to growth at a solid pace. The industrial sector grew at a rate of 2.9% yoy in July, compared to 2.2% yoy in June. Retail trade turnover accelerated to 6.6% yoy and the construction sector expanded by 10.6% yoy. But agricultural output declined by 11.2% yoy in July, due principally to bad weather with high temperatures.
- ❖ In July 2018, the state budget had a deficit of UAH 3.6 billion. This deficit was partially offset by a surplus in local budgets of UAH 0.7 billion. Thus, the consolidated budget had a smaller deficit of UAH 2.9 billion.
- ❖ Consumer inflation posted a significant deceleration for the third consecutive month in July. The all items index dropped 1.0 percentage points to 8.9% yoy.
- ❖ In the banking sector, both deposits and lending showed positive developments in July. Household Hryvnia deposits grew by about 20% yoy while corporate Hryvnia deposits increased by 9.7% yoy. Total Hryvnia loans grew by 12.8% yoy and foreign currency loans denominated in USD posted the first increase in five years at 1.9% yoy.
- ❖ The UAH/USD exchange rate started a depreciatory trend in the second week of August. The major reasons for depreciation were increased demand for dollar from agricultural producers, from non-residents banks for dividends repatriation purposes, and from importers for contract closing purposes. There were also enhanced Hryvnia resources in the Forex market due to repayment of sovereign bonds denominated in Hryvnias.
- ❖ In July 2018, the deficit of the current account of the balance-of-payment of Ukraine increased to USD 1.1 billion (compared to a deficit of USD 401 million in July 2017). This deficit was due to faster imports growth in July (24.9% yoy) than exports (12.6% yoy). Merchandise exports were affected by obstacles imposed by Russia on cargo shipments in the Azov Sea, which resulted in a large fall in the pace of export growth in July. International reserves declined slightly to USD 17.7 billion at the end of July.

<b>Main Macroeconomic Indicators</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018f</b>
<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

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### *Political and Reform Developments*

Ukraine celebrated the 27th anniversary of its independence on August 24. A large number of high level foreign officials joined the parade in Kyiv. The list of participants included the National Security Adviser to President Trump Mr. John Bolton and several defense ministers from NATO member-states. In his opening remarks President Poroshenko announced his initiative to introduce amendments into the Ukrainian Constitution which should define the country's European and Euro-Atlantic course. This statement was re-confirmed by Poroshenko on the opening session of the Verhovna Rada on September 4. Ukraine has already integrated deeply into the NATO efforts in the region. For instance, in September Ukraine began regular joint military exercises with ten NATO states in the western part of the country.

On its on-going 9th session, the Verhovna Rada is expected to advance the legal base for further reforms in the country. The agenda for the fall term includes passing a new law on elections, the preparation a more balanced 2019 state budget, passing further legislation on anti-corruption practices, and increasing the level of national security and defense.

The Ukrainian Ministry of Foreign Affairs has prepared a package of documents to initiate procedures to terminate the Treaty on Friendship, Cooperation and Partnership with the Russian Federation. The treaty was signed in 1997. Termination of the treaty should create a legal base to allow Ukraine to undertake legal actions against Russia in international courts.

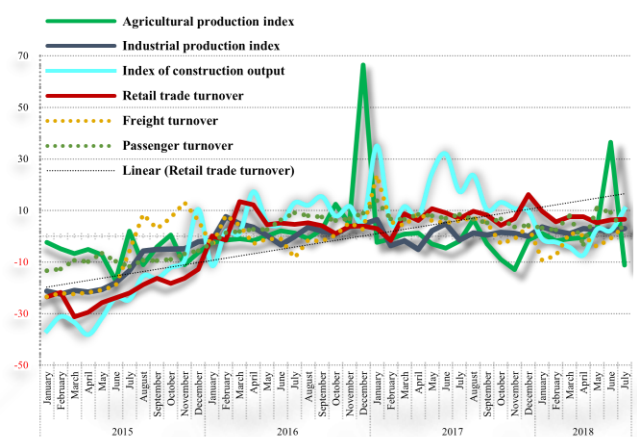
On September 6, an IMF mission started its work in Kyiv. The mission is assessing the current status of the program. It is expected that the main actions that Ukraine will need to implement in order to unblock cooperation with the Fund are increases in gas tariffs for households to international parity level, acceleration of the privatization program, and agreement on a sustainable fiscal budget, including pension reform. Agreement with the IMF on these issues should provide Ukraine with the necessary foreign exchange to ensure financial stability over the medium term.

### *Economic Growth*

According to preliminary data of the State Statistics Service of Ukraine, in the second quarter of 2018, GDP expanded by 3.6% yoy, compared to 3.1% yoy in the first quarter of the year. This growth rate was the highest rate achieved since 2016, and was supported both by higher domestic consumption and investments. In turn, domestic consumption was stimulated by increases in nominal and real monthly wages (24.9% yoy and 14.7% yoy, respectively as of July), and declining inflation rates. Similarly, capital investments expanded by 26.5% in January-July 2018, compared to the same period in 2017.

The latest monthly data for July indicate that the Ukrainian economy has continued to growth at a solid pace. Thus, Ukrainian retail trade turnover accelerated to 6.6% yoy. Similarly, the construction sector expanded by 10.6% yoy. Freight turnover increased by 4.2% yoy, and passenger turnover by 2.8% yoy. On the other hand, agricultural output declined by

**Ukraine Economic Performance, % yoy**  
(To corresponding month of previous year)



Source: State Statistics Committee, the Bleyzer Foundation

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11.2% yoy in July, due principally to volatile weather, with extreme summer temperatures.

Better performance was also achieved in industrial activities, with industrial output increasing by 2.9% yoy in July, compared to 2.2% yoy in June, thanks to a recovery of output in the mining sector. In July, mining output increased by 4.5% yoy, while manufacturing output increased by 2.3%. The better performance in mining was due to an 8.1% yoy increase in mining of metal ores and a 5.7% yoy increase in the extraction of crude and natural gas.

Within manufacturing, its expansion was led by both domestic and export-oriented sectors, as follows: manufacturing of furniture (24.2% yoy), manufacturing of motor vehicles (14.3% yoy), manufacturing of chemicals (9.5% yoy), and metallurgy (5.6% yoy). Coke and refined petroleum output increased by 1.4% yoy. On the other hand, negative growth in output took place in pharmaceutical products (-2.1% yoy), wood products (-1.4% yoy), foodstuffs (-1.9% yoy), rubber & plastic products (-0.9% yoy), and textile industry (-0.8% yoy).

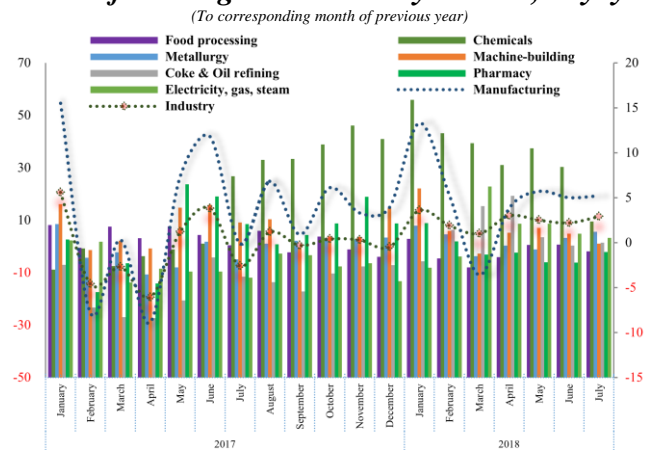
With regard to the geographical distribution of industrial output, the main production growth occurred in the following regions: Sumy (20.4% yoy), Mikolayiv (15.3% yoy), Volyn (11.7% yoy), Chernihiv (11.3% yoy), Ternopil (9.3% yoy), Zakarpattia (9.0% yoy), Ivano-Frankivsk (8.4% yoy), Kharkiv (8.3% yoy), Poltava (7.9% yoy), Dnipropetrovsk (6.6% yoy), Lviv (5.5% yoy), Chernivtsi (4.6% yoy), Zaporizhzhya (3.4% yoy), Vinnytsya (1.9% yoy), Donetsk (1.6% yoy), and Zhytomyr (0.9% yoy).

On the other hand, negative growth in output was shown in Kyiv oblast (-23.8% yoy), Rivne (-16.1% yoy), Kirovohrad (-11.3% yoy), Luhansk (-10.0% yoy), Kherson (-9.8% yoy), Odesa (-9.6% yoy), Kyiv city (-5.9% yoy), Cherkasy (-3.2% yoy), and Khmelnytskyi (-2.2% yoy).

### Fiscal Policy

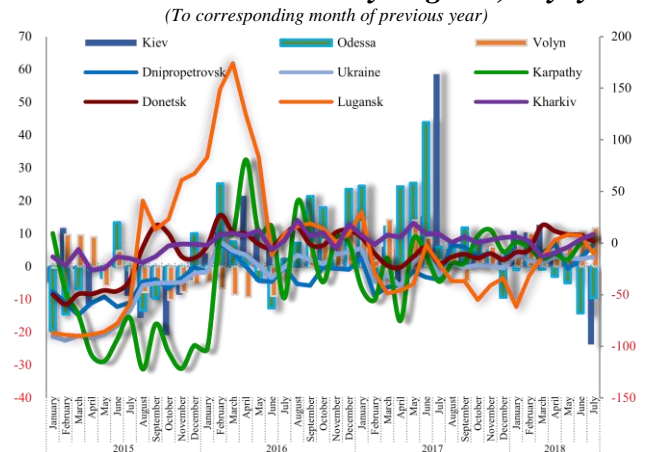
In July 2018, the state budget was executed with a deficit of UAH 3.6 billion. This deficit was partially offset by a surplus in local budgets of UAH 0.7 billion. Thus, the consolidated budget had a smaller deficit of UAH 2.9 billion. The cumulative consolidated budget balance for January-July remained positive but declined to UAH 7.5 billion (about 0.4% of period GDP).

### Manufacturing Production by Sectors, % yoy



Source: State Statistics Committee, the Bleyzer Foundation

### Industrial Production by Regions, % yoy



Source: State Statistics Committee, the Bleyzer Foundation

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Growth of consolidated budget revenues accelerated to 19.1% yoy in July. This was the result of fast expansion of tax revenues (28.4% yoy against 17.1% yoy in June). Tax revenues increased mainly thanks to better economic factors. In particular, the fast growth of receipts from personal income tax continued, thanks to growing wages. Increase in production of tobacco products led to higher receipts from excise taxes. Accelerated growth of receipts from the VAT and taxes on international trade were related to significant growth of imports. Growth of cumulative consolidated budget revenues remained almost unchanged at 15.0% yoy in the first half of 2018.

Growth of consolidated budget expenditures also increased in July but less than the growth of revenues. The growth of expenditures to 24.1% yoy was the result of faster increase in both current and capital expenditures to 19.7% yoy and 66.2% yoy, respectively. In particular, growth of current expenditures accelerated on the back of spending on goods and services (their growth more than doubled to 26.4% yoy). Expenditures on debt servicing declined by 17.3% yoy in July at the expense of domestic debt servicing share. Growth of cumulative consolidated budget expenditures slightly decelerated to 25.3% yoy in January-June.

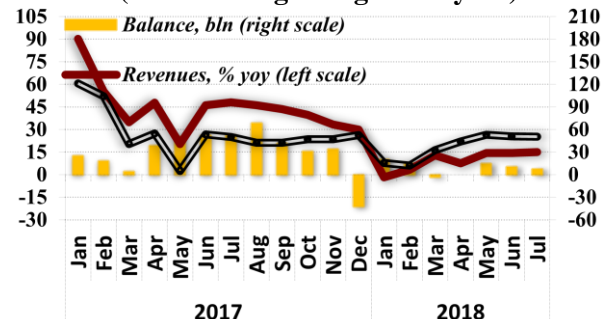
Payments of the government and the NBU on external debt servicing decreased in July. Principal and servicing payments on state debt denominated in foreign currency totaled USD 321.5 million, including payments on sovereign bonds of USD 231.6 million.

### Monetary Policy

**Inflation.** Consumer inflation continued to decelerate in July to 8.9% yoy. The 1.0 percentage point decline in the all-items price index was mainly the result of significantly lower growth in the prices of foodstuffs. Core inflation also posted a minor deceleration to 8.8% yoy but remained rather high due to steady growth of consumer demand caused by fast real wage growth.

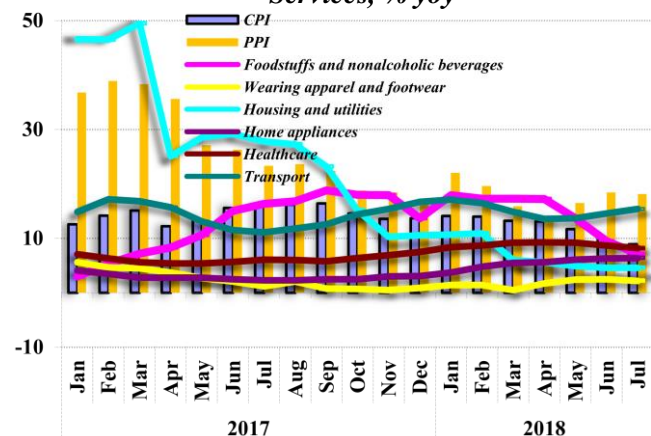
Only a few major groups of goods and services observed significant changes in price dynamics in July. Foodstuffs saw the most significant deceleration in price growth from 9.5% yoy to 7.1% yoy. Restaurants and hotels reported a 0.6 percentage point deceleration in price growth to 15.3% yoy. Growth of healthcare prices decelerated at a much slower pace as it decreased by 0.5 percentage points to 8.2% yoy. Transport was the only major group reporting significant acceleration in growth of prices from 14.6% yoy to 15.4% yoy. For now, we leave our inflation forecast intact at 9.0% yoy for 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.** National currency deposits posted accelerated growth in July. The growth of household hryvnia deposits remained close at about 20% yoy. At the same time, corporate hryvnia deposits posted accelerated growth of 9.7% yoy. Both corporate and household sectors observed accelerated growth in foreign currency deposits denominated in USD at 4.3% yoy and 2.7% yoy, respectively.

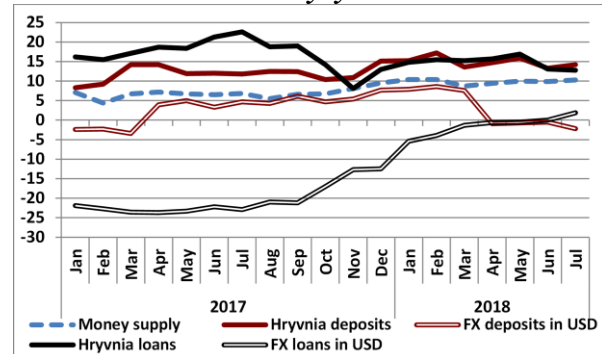
Lending activities of banks saw positive changes in July. Total hryvnia loans grew by 12.8% yoy and foreign currency loans denominated in USD posted the first increase in five years at 1.9% yoy. The growth of national currency loans was the result of growth of household loans (45.1% yoy) and corporate sector loans (6.5% yoy).

The monetary base was virtually unchanged on a month-over-month basis in July, as increases in cash resources offset the decline in balances at the correspondent accounts of banks. However, the year-over-year growth of the monetary base accelerated to 10.8%. Money supply expanded by 1.4% mom thanks to increased cash resources and inflows of total deposits denominated in hryvnia. Thus, the year-over-year growth in money supply accelerated to 10.3%.

**Hryvnia Exchange Rate.** The UAH/USD exchange rate was on a depreciatory trend starting from the second week of August. The major reasons for depreciation were increased demand for dollar from agricultural producers, from non-residents banks for dividends repatriation purposes, and from importers for contract closing purposes. There were also enhanced hryvnia resources in the Forex market due to repayment of sovereign bonds denominated in Hryvnias. The NBU tried to level fluctuations at the interbank forex market through dollar interventions either via auctions or matching platform. But the regulator had limited resources as it has constraints regarding the size of international reserves within the IMF Program, and significant principal and servicing payments on external debt due in September.

Within its program of foreign currency market reform, the NBU lifted the obligatory registration and confirmation of the foreign exchange deals in its System of Confirmation of Deals at the Interbank Forex Market of Ukraine and allowed banks to transfer to Bloomberg and Reuters trade and information systems starting on August 1<sup>st</sup>. However, the initiative backfired as many players of the foreign market lost access to information on the daily exchange rate dynamics at the interbank forex market. Cash foreign currency market players tried to cover their risks and increased their prices of the foreign exchange services increasing the gap between the cash and interbank exchange rates. This, in turn, created opportunities for speculators and imposed additional depreciatory pressure on the hryvnia.

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



Source: The NBU, The Bleyzer Foundation

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



Source: The NBU, The Bleyzer Foundation

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### International Trade and Capital

In July 2018, the deficit of the current account of the balance-of-payment of Ukraine increased by 175% year-over-year to USD 1.1 billion (compared to a deficit of USD 401 million in July 2017). This deficit was due to faster imports growth in July (24.9% yoy) than exports (12.6% yoy). Merchandise exports were affected by obstacles imposed by Russia on cargo shipments in the Azov Sea, which resulted in a large fall in the pace of export growth in July.

In July, the main export growth took place in the following commodity groups: mineral products/energy (26% yoy), chemicals (21% yoy), ferrous & nonferrous metals (20% yoy), timber & wood products (17% yoy), industrial goods (16% yoy), agricultural products (8% yoy) and machinery & equipment (3% yoy). Only informal trade dropped by 19% yoy.

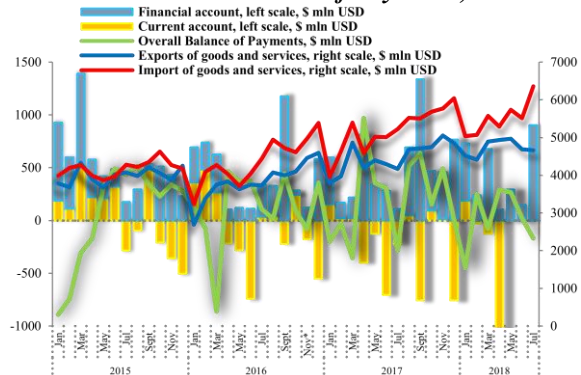
Ukraine's merchandise imports increased in each sector, as follows: informal trade (39.1% yoy), mineral products (33% yoy), ferrous & nonferrous metals (31% yoy), agricultural products (30.8% yoy), industrial goods (28.1% yoy), timber and wood products (24.6% yoy), chemicals (18.3% yoy), and machinery & equipment (16% yoy), respectively.

Regarding merchandise trade by regional orientation, in January-July 2018, Ukraine exports to Europe grew by 18.1% yoy, while imports from the EU expanded at a rate of 10.9% yoy. At the same time, Ukrainian merchandise trade with the Russian Federation dropped by -8.3% yoy, but import of goods from Russian Federation to Ukraine grew by 25.1% yoy.

Net inflows of the financial account financed only a portion of the current account deficit. They amounted to USD 902 million, compared to USD 109 million, in July 2017. These financial inflows in July were generated by Foreign Direct Investments (USD 142 million - 83% of which directed to the real sector of Ukraine) and loans to the private sector (USD 956 million).

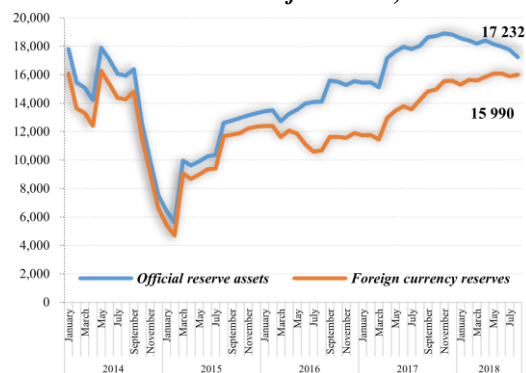
As the current account deficit exceeded financial inflows, the overall balance of payments had a deficit of USD 170 million. Accordingly, the level of international reserves declined to USD 17.7 billion by the end of July 2018, which were enough to cover 3 months of the future imports.

**Ukraine's External Balance of Payments, mln USD**



Source: NBU, The Bleyzer Foundation

**International Reserve of Ukraine, mln USD**



Source: NBU, The Bleyzer Foundation

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