

September 2019

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### Executive Summary

- ❖ The first session of Ukraine's new Parliament (Verkhovna Rada) took place on August 29. It appointed Dmytro Razumkov (number one in the list of MPs from Servant of the People Party) as Speaker of the Parliament. The Verkhovna Rada also appointed Oleksiy Honcharuk as Prime Minister, followed by the appointment of the members of the Cabinet of Ministers. The President submitted to Rada a number of anticorruption draft laws. The Rada also limited the deputies' immunity to legal action against the results of their voting and political statements.
- ❖ A swap of 35-for-35 prisoners between Russia and Ukraine was completed on September 7<sup>th</sup>, which has risen expectations that further peace progress may be possible.
- ❖ In the second quarter of 2019, Ukraine's GDP grew by 4.6% yoy, compared to 2.5% yoy in the first quarter of the year. On a quarter-over-quarter basis, the seasonally adjusted rate of real GDP growth was 1.6% qoq. These are some of the highest rates of GDP growth since 2011. More frequent monthly output data show that the economy recovery is still ongoing. The principal driver of economic growth is domestic consumption, supported by higher wages and foreign remittances.
- ❖ The overall fiscal budget situation continues to be satisfactory, with a consolidated surplus UAH 22.7 billion in January-July (0.9% of period GDP).
- ❖ Consumer inflation remained almost unchanged in July, with an all items index of 9.1% yoy. Core inflation also remained unchanged at 7.4% yoy for the third month in a row.
- ❖ In the banking sector, in July Hryvnia deposits grew at a rate of 7.0% yoy, while foreign currency deposits saw their growth accelerating almost six times to 13.6% yoy. Bank lending posted sluggish performance in July, with Hryvnia loans growing by 3.2% yoy while foreign exchange loans declined at a rate of 6.1% yoy.
- ❖ The UAH/USD exchange rate remained stable during August, finishing the month at around 25.2 UAH/USD.
- ❖ In July 2019, the deficit in the current account of the balance of payments declined by 38.5% yoy to USD 609 million, compared to the deficit of USD 990 million in July 2018. The deficit was fully covered by financial inflows which reached USD 1,852 million in July 2019, an increase of 134% yoy. These inflows led to an increase in international reserves, which reached USD 22.0 billion (about 3.5 months of imports).

<b>Main Macroeconomic Indicators</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019f</b>
<i>GDP, USD billion</i>	180	130	87	93.4	113	131	146
<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 GDP</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	60.9	59.0
<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	28.0
<i>Current Account Balance, % of GDP</i>	-9.2	-3.5	1.8	-1.5	-2.2	-3.3	-3.4
<i>Merchandise Exports, USD billions</i>	59	51	35	34	40	43	45
<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	19.0
<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

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## ***Political and Reform Developments***

The first official session of Ukraine's newly elected Verkhovna Rada took place on August 29. It appointed Dmytro Razumkov as Speaker. The Verkhovna Rada then appointed Oleksiy Honcharuk as Prime Minister. Subsequently, the members of the Cabinet of Ministers were appointed as follows: Dmytro Kuleba - Vice Prime Minister for European and Atlantic Integration; Mykhailo Fedorov - Vice Prime Minister and Minister for Digital Transformation; Dmytro Dubilet - Minister of the Cabinet of Ministers; Tymofii Mylovanov - Minister of Economic Development, Trade and Agriculture; Oksana Markarova - Minister of Finance; Oleksiy Orzhel - Minister of Energy and Environment Protection; Vladyslav Kryklii - Minister of Infrastructure; Aliona Babak - Minister of Development of Communities and Territories; Andrii Zagorodniuk - Minister of Defense; Hanna Novosad - Minister of Education and Science; Zoryana Skaletska - Minister of Healthcare; Volodymyr Borodiansky - Minister of Culture, Youth and Sports; Yulia Sokolovska - Minister of Social Policy; Arsen Avakov - Minister of Internal Affairs; Oksana Koliada - Minister for Veterans' Affairs, Temporarily Occupied Territories and Internally Displaced People; Denys Maliuska - Minister of Justice; and Vadym Prystaiko - Minister for Foreign Affairs; . Other appointments included Ivan Bakanov - Head of Ukraine's State Security Service, SBU; and Ruslan Riaboshapka - Prosecutor General. Another major decision was made close to the end of the first Rada session, when deputies adopted draft changes to the Constitution of Ukraine to limiting deputies' immunity. MPs will not be immune if they breaks the law; but MPs will not be responsible legally for the results of their voting, statements about the parliament and its bodies, excluding the responsibility for insulting or defamation. The final law was approved on September 4<sup>th</sup>. The President also submitted a number of draft laws on anti-corruption.

President Zelenskyy spoke during the first Rada session. He said that this Rada has plenty of challenges and tasks ahead of it. "That includes implementation of government by the people, and the long-anticipated lifting of parliamentary immunity; the impeachment law; an effective reform of law enforcement agencies and the judicial system; continuation of reforms of decentralization and European integration; liberalization of the economy; creation of a powerful investment magnet to attract foreign investments; the development of a digital state that fits in the smartphone - so that the lines at government offices and the hellish bureaucracy are finally gone. Fighting raids, fighting monopolies, fighting illegal trafficking, gaining true energy independence, energy efficiency and solving problems with the utility tariffs, developing industry, the agrarian sector, infrastructure, and medicine; improving our education system and restoring Ukrainian science. What is most important - strengthening national security and defense, finishing the war in Donbas and returning Crimea, which was annexed by Russia. Our society expects all that, and we have to do it all."

President Zelenskyy added that this Parliament will make history. "The only question is - what kind of history you will make; as a Parliament that achieved the unbelievable things, which brought to life everything they failed to do over the previous 28 years..... Or else, you can make history as the Parliament that lasted the least - one year."

The government has now listed specific reform measures that it intends to undertake in the next 100 days. They include most of the major actions that Ukraine's civil society and international partners had been suggesting for years as the most important reforms to establish a free and competitive market economy that can deliver high rates of growth and improvements in the country's standard of living. The government has made a very good start. The challenge is now to transform all these intentions into reality. The country is well-positioned to deliver the above reforms as the President now has control of the Rada and the Cabinet of Ministers.

On the war side, there was some progress in Donbas in August. Although separatists continue violating the ceasefire, separation of forces in Stanitsa Luganska was finalized and Ukrainian forces started dismantling of fortifications. Finally, a swap of 35-for-35 prisoners between Russia and Ukraine was completed on September 7<sup>th</sup>, which has risen expectations that further peace progress may be possible.

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**Economic Growth**

According to preliminary data of the State Statistics Service of Ukraine, in the second quarter of 2019 GDP expanded by 4.6% yoy, compared to 2.5% yoy in the first quarter of the year. On a quarter-over-quarter basis, the seasonally adjusted rate of real GDP growth was 1.6% qoq. These are some of the highest rates of growth since 2011.

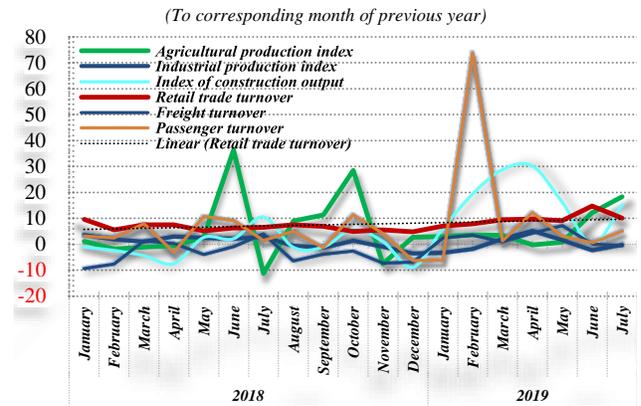
More frequent monthly output data show that the economy recovery is still ongoing. The principal driver of economic growth is domestic consumption, supported by higher wages and foreign remittances. Nominal and real monthly wages increased by 19.6% yoy and 9.5% yoy, respectively in July. On the supply side, strong performance was shown by the agricultural sector (with a growth rate of 18.3% yoy), construction output (15.2% yoy growth rate), retail trade turnover (9% yoy growth rate), and passenger turnover (4.4% yoy growth rate).

On the other hand, Ukrainian industrial production dropped by 0.2% yoy in July 2019, following a reduction of 2.3% yoy in the previous month. Recent declines were due in part to increasing difficulties in freight transportation which deteriorated by 0.6% yoy. However, industrial output reductions were also caused by a large number of industrial production repairs with related maintenance works. Almost all manufacturing sectors suffered output failures in July on a year-to-year basis, except for pharmaceutical (14.6% yoy), foodstuffs products (4.4% yoy), as well as rubber and plastic goods (1.4% yoy). Industrial production experienced output shrinkages in the following sectors: coke & refined petroleum products (-12.6% yoy); textile industry (-10.2% yoy); metals goods (-3.2% yoy); wood products, paper & printing (1.4% yoy); machinery & equipment (-1% yoy); and both furniture with chemicals products (-0.6% yoy).

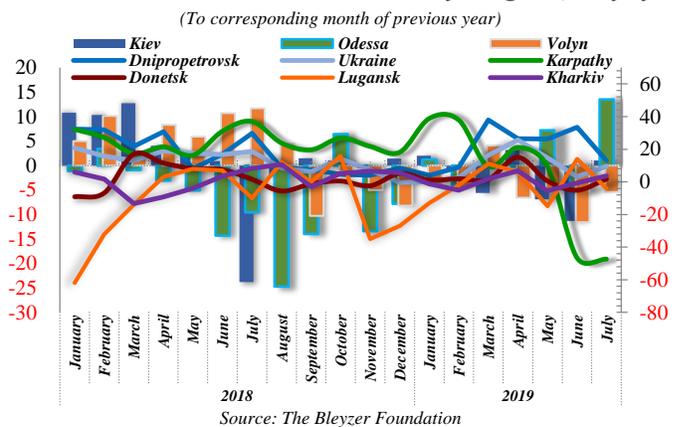
Poor performance also took place in the supply of electricity, gas, steam and air conditioning, which had a reduction of -3.6% yoy. On the other hand, Ukrainian mining of coal and lignite continued to accelerate growth with an expansion of 6.8% yoy in July 2019.

With regard to the geographical distribution of industrial output, the highest production growth occurred in the following regions: Vinnytsya (21.9% yoy), Kirovohrad (18% yoy), Rivne (17.4% yoy), Odesa (13.5% yoy), Kherson (9.5% yoy), Ternopil (8.4% yoy), Kharkiv (3.7% yoy), Cherkasy (2.4% yoy), Kyiv city (1.9% yoy), Donetsk (1.7% yoy), Dnipropetrovsk and Kyiv region (1% yoy). However, negative results took place in the following oblasts: Zakarpattya (-19.1% yoy), Khmelnytskyi (-18.3% yoy), Chernihiv (-15.7% yoy), Zhytomyr (-12.4% yoy), Chernivtsi (-8.9% yoy), Ivano-Frankivsk (-6.7% yoy), Sumy (-6.7% yoy), Mikolayiv (-6.5% yoy), Volyn (-5.4% yoy), Zaporizhzhya (-4.3% yoy), Luhansk (-4% yoy), Lviv (-3.1% yoy), Poltava (-2.1% yoy).

**Ukraine Economic Performance by Sector, % yoy**



**Ukraine Industrial Production by Region, % yoy**



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**Fiscal Policy**

The consolidated fiscal budget balance became positive in July, supported by surpluses in local budgets. The cumulative surplus of local budgets of UAH 3.7 billion more than offset the state budget deficit of UAH 2.0 billion during the month. The government continued to borrow heavily to finance budget execution. Net borrowings totaled UAH 32.3 billion. Cumulative surplus from the beginning of the year amounted to UAH 22.7 billion in January-July.

After a couple months of decelerated growth, consolidated budget revenues grew faster in July. Total revenues expanded by 20.4% yoy. This was mainly the result of a trend reversal in non-tax revenues, which grew by 89.7% yoy. In addition, tax revenues also grew faster than a month ago (12.9% yoy against 8.5% yoy). Fast growth of non-tax revenues was the result of 2018 profits transfers to the budget by Naftogaz. Growth of tax revenues was stimulated by continued growth of nominal wages (leading to a 27.0% increase in personal income tax receipts), lower VAT reimbursements (with higher VAT contributions that caused expansion of VAT receipts by 51.8% yoy), and faster growth of imports (receipts of excise taxes on imported goods grew by 18.7% yoy). The growth of cumulative consolidated budget revenues from the beginning of the year accelerated to 14.2% yoy.

Consolidated budget expenditures continued to grow at a high rate in July. Faster growth in both current and capital expenditures pushed total growth of expenditures upwards by 2.5 percentage points to 13.8% yoy. Growth of current transfers significantly decelerated but remained the highest among current expenditures at 50.3% yoy. Payroll expenditures grew slightly faster this month at 17.7% yoy. Growth of the social security expenditures more than doubled to 15.4% yoy. Expenditures on state debt servicing declined by 1.4% yoy. Among the major reasons was the appreciation of the exchange rate in July. Cumulative consolidated budget expenditures from the beginning of the year grew by 12.0% yoy.

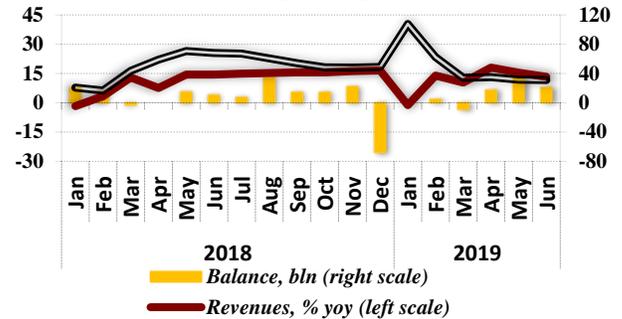
Foreign currency denominated state and guaranteed debt payments increased in July. Total payments were at USD 1.0 billion equivalent, of which USD 941 million was spent on servicing and redemption of domestic sovereign bonds denominated in foreign currency. The rest of USD 77.7 million equivalent was paid on other liabilities to foreign creditors and IFIs.

**Monetary Policy**

**Inflation.** Consumer inflation remained almost unchanged in July. The all items index was at 9.1% yoy, slightly up of 9.0% yoy in June because of faster growth in prices of some whole foods. Core inflation remained unchanged at 7.4% yoy for the third month in a row.

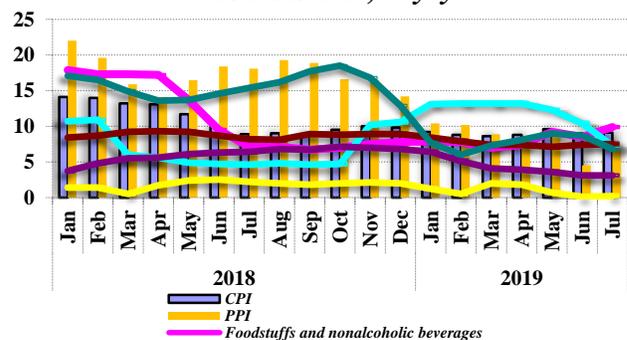
Deceleration in growth of prices of housing and utilities by 3.1 percentage points to 7.3% yoy, of transport by 2.9 percentage points to 6.8% yoy, and of alcoholic and tobacco products by 0.7 percentage points to 15.2% yoy almost fully offset acceleration in growth of foodstuffs prices by 1.4 percentage points to 9.9% yoy. Other

*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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major groups of goods and services saw almost no changes in price growth. Taking into account the latest developments, we leave our forecast for inflation unchanged at 8.0% yoy at the end of the year.

**Banking Sector.** There were mixed developments in banking deposits in July. National currency deposits grew at a slower rate of 7.0% yoy, while foreign currency deposits denominated in USD saw their growth accelerating almost six times to 13.6% yoy. Household deposits further expanded relatively fast at 12.1% yoy thanks to continued growth in wages. Corporate deposits, though, saw their growth dropping from 7.1% yoy to just 3.3% yoy. As for foreign currency deposits denominated in USD, both corporate and household segments posted faster growth. But corporate deposits grew faster (35.8% yoy versus 4.9% yoy) because of funds received from Eurobond placement.

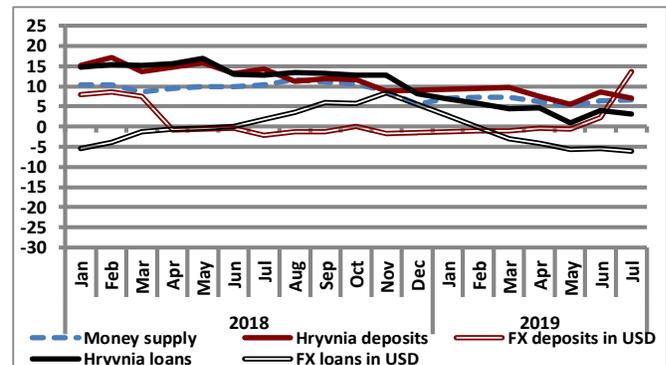
Bank lending activities posted a sluggish performance in July. National currency loans grew at 3.2% yoy (0.8 percentage points slower than in June) due to a decline in corporate loans (3.3% yoy), and despite fast growth of household loans (27.2% yoy). Foreign exchange loans denominated in USD continued to decline. The decline accelerated to 6.1% yoy as corporate loans decreased faster at 4.7% yoy, while the rate of decline in household loans remained high (14.2% yoy).

The monetary base posted a decline of 2.0% mom in July. This, however, had little effect on its over-year growth, which remained almost unchanged at 3.8% yoy. Money supply, in turn, continued to expand in both monthly and over-year terms. Furthermore, its over-year growth accelerated to 6.7% despite some monthly growth deceleration (to 1.8%).

**Hryvnia Exchange Rate.** Apart from a short period of depreciation at the beginning of the month, the UAH/USD exchange rate was relatively stable in August. Large purchases of dollar by the NBU over the last several trading sessions of July led to depreciation of the exchange rate at the beginning of August. However, low hryvnia resources and another auction of domestic sovereign bonds denominated in hryvnia held by the Ministry of Finance on August 6<sup>th</sup> reversed the trend at the interbank market. The exchange rate appreciated back to the level observed at the end of July and did not post any significant fluctuations by the end of August finishing the month at around 25.24 UAH/USD.

In line with its program of the currency exchange liberalization, the NBU lifted limitations on foreign exchange purchases of businesses using loan funds. The regulator also improved its supervision procedures of the foreign trade settlements.

### *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 2019 the deficit in the current account of the balance of payments declined by 38.5% yoy to USD 609 million, compared to the deficit of USD 990 million in July 2018.

This reduction in the CA deficit was due to faster growth of merchandise and service exports in July (16.9% yoy) than imports growth (8.9% yoy). The main driver was merchandise exports which had a growth of 20.3% yoy in July. In July, the main merchandise export growth took place in the following commodity groups: machinery & equipment (45.1% yoy); mineral products/energy (37.6% yoy), agricultural products (36.5% yoy); industrial goods (9.5% yoy), and ferrous & nonferrous metals (1.2% yoy). On the other hand, export reductions took place in timber & wood products (-9.5% yoy), informal trade (-11.4% yoy) and chemicals (2.4% yoy).

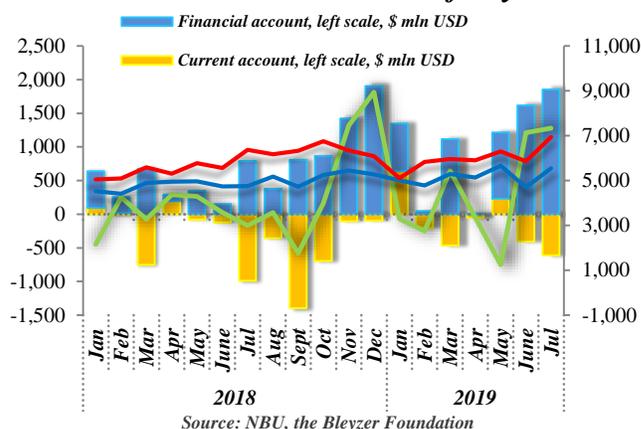
In July 2019 Ukraine’s merchandise imports increased almost in each sector, as follows: machinery & equipment (36% yoy), industrial goods (24.9% yoy), ferrous & nonferrous metals (9.7% yoy), agricultural products (8.6% yoy), and chemicals (4.2% yoy). Negative growth in exports resulted in informal trade (39.1% yoy), mineral products (33% yoy), and timber/wood products (-9.8% yoy).

Regarding merchandise trade by regional orientation, in January-July 2019, Ukraine exports to Europe grew by 12% yoy, while imports from the EU expanded at a rate of 12.4% yoy. At the same time, Ukrainian merchandise trade with the Russian Federation fell by -14.8% yoy, but import of goods from Russian Federation to Ukraine was reduced only by -2.7% yoy. At the same time, the deficit in merchandised trade turnover in Ukraine increased by 12.9% yoy to USD 6.8 billion, of which 41% of the deficit was related to Russian Federation turnover, which expanded by 5.6% yoy to USD 2.8 billion.

In the financial account, in July 2019 net financial inflows increased by 134.4% yoy to USD 1,852 million, compared to the same period of the previous year (USD 790 million). These inflows financed the full amount of the current account deficit. On month-over-month basis net inflow of financial account increased by 14.6% yoy in July 2019. The financial inflows in July were generated by net inflow of portfolio investments (related by the purchase by foreigners of government debt), which grew by 51% mom to USD 2,590 million. In addition, in July foreign direct investments increased by 25% yoy to USD 170 million.

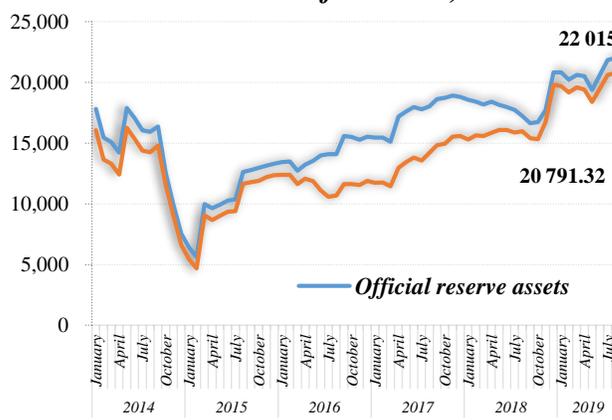
As the current account deficit not exceeded financial inflows, the overall balance of payments had a surplus of USD 1,280 million, compared to a deficit of USD 170 million in July of the previous year. Accordingly, the level of international reserves increased to USD 22.0 billion by the end of July 2019, which were enough to cover 3.5 months of the future imports.

**Ukraine's External Balance of Payments**



Source: NBU, the Bleyzer Foundation

**International Reserve of Ukraine, million USD**



Source: NBU, the Bleyzer Foundation

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