

June 2018

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### Executive Summary

- ❖ In June, the Verhovna Rada enacted the new Anticorruption Court Law. Amendments made in July removed some deficiencies in the law, in particular, the proposal that those cases that had been already investigated by NABU should be handled by regular courts and not the new Anticorruption Court. The passage of this amended law is an important step to address corruption in the country. It should pave the way for future co-operation with the IMF and EU. Also in July, Verhovna Rada passed a bill to facilitate the sale of loan collaterals, which in the past required a court decisions.
- ❖ The latest release of the State Statistics Committee confirmed that GDP grew by 3.1% yoy in the first quarter of 2018. The mayor sources of GDP growth were gross capital formation (17% yoy) and household consumption (5.6% yoy).
- ❖ Monthly data showed recovery in most economic sectors in May 2018. Agricultural production showed positive sign for the first time in three months (2.6% yoy, 6.4% mom), and construction output increased by 2.7% yoy (20.5% mom). In like manner, Ukrainian retail trade and passenger turnover increased by 4.9% yoy and 10.8% yoy, respectively. Industrial production also grew by 2.5% yoy in May 2018, with manufacturing increasing by 3.2% yoy.
- ❖ The consolidated budget was executed with a surplus for the second consecutive month in May. Both state and local budgets were in surplus. As a result, the consolidated budget was in surplus of UAH 14.6 billion in January-May.
- ❖ Consumer inflation significantly decelerated in May. The all items index decreased from 13.1% yoy to 11.7% yoy mainly thanks to sharp deceleration in growth of foodstuffs prices.
- ❖ In the banking sector, national currency deposits grew at an accelerated rate, while foreign currency deposits denominated in USD declined for the second month in a row. Growth of national currency deposits accelerated thanks to faster expansion of corporate deposits (by 11.6% yoy). Bank lending activities improved again in May. Growth of national currency loans accelerated to 16.9% yoy.
- ❖ The UAH/USD exchange rate remained stable in May, ending the month at around 26.3 UAH/USD.
- ❖ In May 2018 the current account of the balance of payments had a small deficit of USD 41 million. Significant growth of the primary & secondary net income surpluses of USD 419 million and USD 326 million, partly compensated a large imbalance of USD 913 million in the merchandise trade account. Financial inflows of USD 307 million, led to an increase in international reserves to USD 18.2 billion.

<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>
<b>GDP, USD billion</b>	173	180	130	87	93.4	104	113
<b>Real GDP Growth, % yoy</b>	0.2	0.0	-6.6	-9.9	2.3	2.5	3.5
<b>Fiscal Balance (incl. Naftogaz/Pension Fund), % of GDP</b>	-5.5	-6.5	-11.7	-2.1	-2.3	-1.5	-2.5
<b>Public Debt, External and Domestic, % of GDP</b>	36.6	40.4	69.4	79.1	81.2	78.5	78.0
<b>Consumer Inflation, eop, % yoy</b>	-0.2	0.5	24.9	43.3	12.4	13.7	9.0
<b>NBU Key Policy Interest Rate, % eop</b>	7.5	6.5	14.5	17.0	16.7	16.4	17.0
<b>Hryvnia Exchange Rate per USD, eop</b>	8.1	8.2	15.8	24.0	27.1	28.1	28.0
<b>Current Account Balance, % of GDP</b>	-8.3	-9.2	-3.5	-0.2	-3.8	-3.7	-3.5
<b>Merchandise Exports, USD billions</b>	64	59	51	35	34	40	43
<b>Merchandise Imports, USD billions</b>	86	81	58	39	40	49	52
<b>FDI, Net Annual Inflow, USD billion</b>	8.4	4.5	0.4	3.0	3.3	2.3	5.0
<b>International Reserves, USD billion</b>	24.5	20.4	7.5	13.3	15.5	18.8	21.0
<b>Public External Debt, USD billion</b>	32.1	31.7	34.9	42.6	42.5	47.0	52.0
<b>Private External Debt, USD billion</b>	102.3	110.3	91.2	76.0	69.9	67.0	72.0

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### Political and Reform Developments

In June, the Verhovna Rada enacted the new Anticorruption Court Law. The review of the law by the Venice Commission (VC), international institutions, and local NGOs revealed some deficiencies, particularly the proposal that those cases that had been already investigated by NABU should be handled by regular courts and not the new Anticorruption Court. However, subsequent amendments were passed in July to ensure that all cases of corruption will be handled by the new Court. The passage of this amended law is an important step to address corruption in the country. It should pave the way for future co-operation of Ukraine with the IMF and EU.

In July, Verhovna Rada passed a Bill on Activation of Bank Lending, which should positively affect state of the country's banking sector. Currently commercial banks were required to have a court decision in order to use a collateral. The old scheme did not provide creditors with the required level of protection. According to the newly passed law all procedures related to forced sale of collateral would be significantly eased and put in line with international standards.

### Economic Growth

The latest release of the State Statistics Committee confirmed that real GDP grew by 3.1% yoy in the first quarter of 2018. The mayor sources of GDP growth were gross capital formation (17% yoy) and household consumption (5.6% yoy). On the other hand, Ukrainian general government expenditures decreased by -1.4% yoy. Foreign trade had a reduction in exports (-9.9% yoy) and in imports (-5.4% yoy).

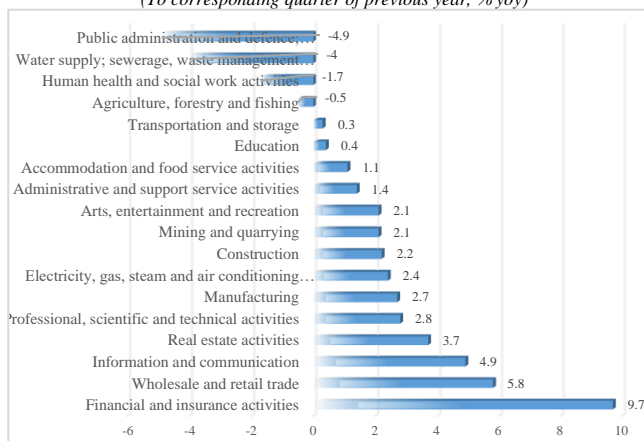
On the supply side of GDP, the largest expansion in 1Q of 2018 took place in financial & insurance activities with a 9.7% yoy increase, followed by wholesale & retail trade, which rose by 5.8% yoy, and by information with communication, which grew by 4.9% yoy. In addition, Ukrainian real estate activities expanded by 3.7% yoy, professional, scientific & technical activities rose by 2.8% yoy, and manufacturing increased by 2.7% yoy.

Monthly data showed recovery in most economic sectors in May 2018. Agricultural production showed positive sign for the first time in three months (2.6% yoy, 6.4% mom), and construction output increased by 2.7% yoy (20.5% mom). In like manner, Ukrainian retail trade and passenger turnover increased by 4.9% yoy and 10.8% yoy, respectively. Industrial production also grew by 2.5% yoy in May 2018, with manufacturing increasing by 3.2% yoy.

Within manufacturing, the main growth activities took place in chemicals & chemical products, which grew

### GDP Production Side - Q1 2018

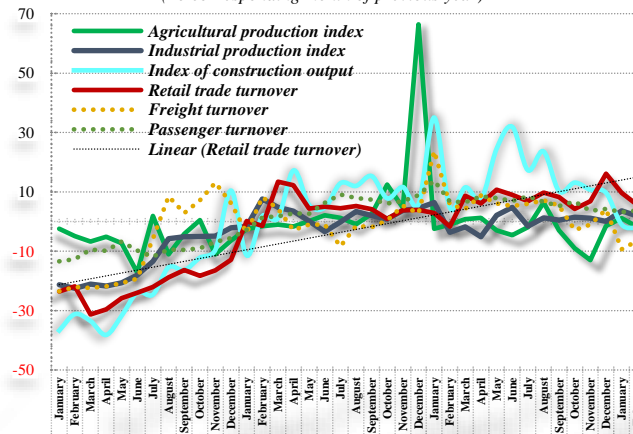
(To corresponding quarter of previous year, % yoy)



Source: The Bleyzer Foundation

### Ukraine Economic Performance, % yoy

(To corresponding month of previous year)



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by 37.4% yoy; electricity, gas, steam & air conditioning supply, by 8.6% yoy; engineering, by 7% yoy; rubber & plastic products (6.2% yoy); furniture & other repair & installation of machinery & equipment (4.9% yoy); and coke & refined petroleum products (3.5% yoy). But the following subsectors experienced declines in output on a year-over-year basis: basic pharmaceutical products (-6.1% yoy), textile industry (-1.3% yoy) and metallurgy (-1.2% yoy).

Regarding regional growth, in May 2018 the largest increase in industrial output took place in the following oblasts: Ivano-Frankivsk (16.9% yoy), Donetsk (8.1% yoy), Luhansk (8% yoy), Ternopil (6.9% yoy), Zaporizhzhya (6.6% yoy), Volyn (5.9% yoy), Lviv (4.5% yoy). On the other hand, the regions with the largest declines in output were Rivne (-13.9% yoy), Khmelnytskyi (-10.8% yoy), Odesa (-5.1% yoy), Chernihiv (-4.7% yoy), Mikolayiv (-4% yoy), Kharkiv (-4% yoy), Sumy (-2.5% yoy), Kherson (-1.3% yoy) and Dnipropetrovsk (-0.6% yoy).

### **Fiscal Policy**

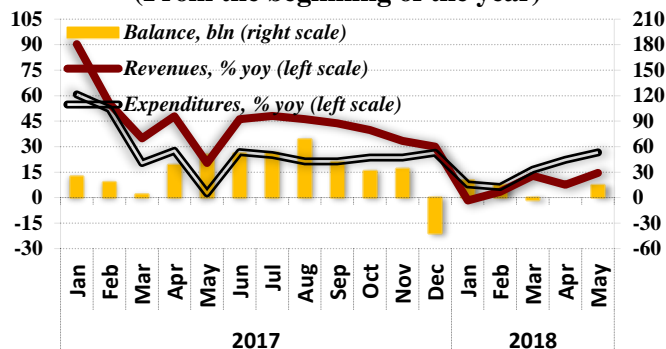
The consolidated budget was executed with a surplus for the second consecutive month in May. Both state and local budgets were in surplus (UAH 11.4 billion and UAH 3.1 billion respectively). As a result, the consolidated budget was in surplus of UAH 14.6 billion in January-May. As in the previous month, the government used the surplus to repay loans previously taken to finance budget execution (net repayment totaled UAH 4.9 billion). Also the government pumped out of the economy UAH 8.8 billion of cash and extracted another UAH 0.8 billion through other instruments of liquidity regulation.

Consolidated budget revenues were back to growth in May. The 40.7% yoy growth was caused by economic factors and some temporary factors. In particular, the statistical base effect from transfer of funds confiscated from Yanukovych in 2017 already finished. At the same time, transfer of the 2017 NBU's profits was shifted to Q2 with the maximum transfer of UAH 17 billion being executed in May. This caused the 115.0% yoy increase in nontax revenues. Tax revenues continued to grow at fast although slightly decelerated rate of 27.8% yoy. This growth was ensured by accelerated growth of receipts from corporate profit tax (43.7% yoy) and continued growth of receipts from personal income tax (27.8% yoy). Growth of receipts from the VAT decelerated because of higher reimbursements to exporters but remained high at 18.3% yoy. Receipts from excise taxes returned to growth mainly thanks to increased imports. Growth of the cumulative consolidated budget revenues almost doubled to 14.5% yoy in January-May.

Growth of consolidated budget expenditures further accelerated in May. The 43.4% yoy growth was the result of expansion in both current and capital expenditures, although the later expanded twice as fast as the former (83.8% yoy against 40.7% yoy). Growth in current expenditures was stimulated by fast growth of expenditures on debt servicing (87.6% yoy). Expenditures on goods and services, on social security, and payroll expenditures also grew at high rates (41.9% yoy, 37.1% yoy, and 30.1% yoy respectively). In January-May, growth of cumulative consolidated budget expenditures further accelerated reaching 26.5% yoy.

Payments of the government and the NBU on external debt servicing significantly increased in May. In particular, USD 455.1 million equivalent was paid to the IMF. Other principal and servicing payments on state debt

**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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denominated in foreign currency totaled USD 214.4 million, including payments on sovereign bonds of USD 126.2 million and payments on sovereign eurobonds of USD 18.5 million.

### Monetary Policy

**Inflation.** Consumer inflation significantly decelerated in May. The all items index decreased from 13.1% yoy to 11.7% yoy mainly thanks to sharp deceleration in growth of foodstuffs prices. Better weather conditions as compared to last year and increases in imports led to a larger supply of foodstuffs limiting growth of their prices. At the same time, pressure on prices on the side of production cost, particularly wages, and on the side of recovering consumer demand remained. Core inflation inched down to 9.3% yoy.

Apart from foodstuffs, notable deceleration in growth of prices was observed for alcoholic beverages and tobacco products (by 1.1 percentage points to 19.4% yoy), housing and utilities (by 0.7 percentage points to 4.9% yoy), and restaurants and hotels (by 0.7 percentage points to 16.4% yoy). Home appliances was the only major group of goods and services observing notable acceleration in growth of prices (by 0.5 percentage points to 6.1% yoy). Other major groups of goods and services observed little or no changes in price dynamics in May.

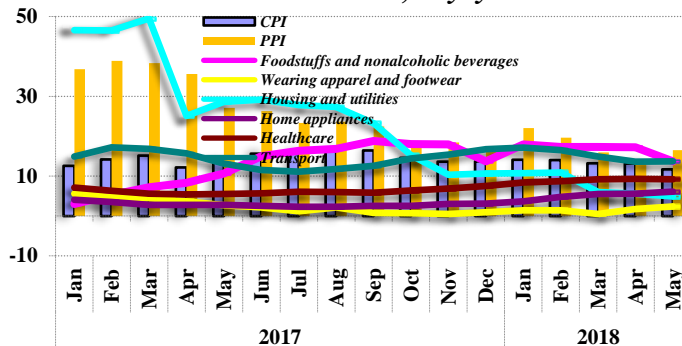
**Banking Sector.** Bank deposits posted mixed developments in May. National currency deposits grew at an accelerated rate, while foreign currency deposits denominated in USD declined for the second month in a row. Growth of national currency deposits accelerated thanks to faster expansion of corporate deposits (by 11.6% yoy compared to 8.0% yoy in April).

Bank lending activities improved again in May. Growth of the national currency loans accelerated to 16.9% yoy thanks to accelerated increase in household loans (45.2% yoy) and growth of corporate loans (11.6% yoy). The decline of the foreign currency loans decelerated again inching down to 0.5% yoy mainly thanks to faster growth of corporate loans (3.2% yoy) as household loans continued to decline rather fast (by 17.9% yoy).

The decline in cash resources together with lower balances at the correspondent accounts of banks led to some monthly decline of the monetary base (by 1.2%) and deceleration in its over-year growth (to 10.6%). At the same time, money supply slightly expanded in May (by 0.5% mom and 10.0% yoy).

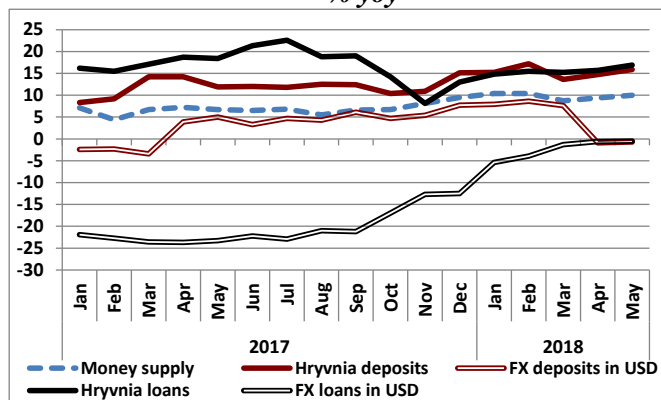
**Hryvnia Exchange Rate.** The UAH/USD exchange rate was stable during the first half of June. However, repatriation of dividends by non-residents and the VAT reimbursements led to gradual depreciation of the exchange

**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

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rate from June 13th to June 20th. Then the exchange rate appreciated back to the level observed at the beginning of the month but not for long, as another tranche of the VAT reimbursements caused depreciation at the end of the month. Overall, the exchange rate depreciated by 0.8% to around 26.34 UAH/USD in June.

The NBU continued reforming the foreign exchange market in May. The regulator simplified the procedures for foreign exchange operations. First, the NBU decreased the number of paper documents needed for a foreign exchange operation for banks (they may save only electronic version of the document and may not print the document for the client on his/her consent). Second, banks and financial institutions are now allowed to conduct foreign exchange operations through chip and pin machines. Third, banks and financial institutions are allowed to prepare reports on foreign exchange operations in the form of electronic document. Also, observing positive results from changes in foreign exchange positions of banks introduced earlier, the regulator decided to equalize them introducing equal limits for long and short foreign exchange positions of banks at 5%.

**Dynamics of the Average Weighted UAH/USD Exchange Rate in the Interbank Forex Market**

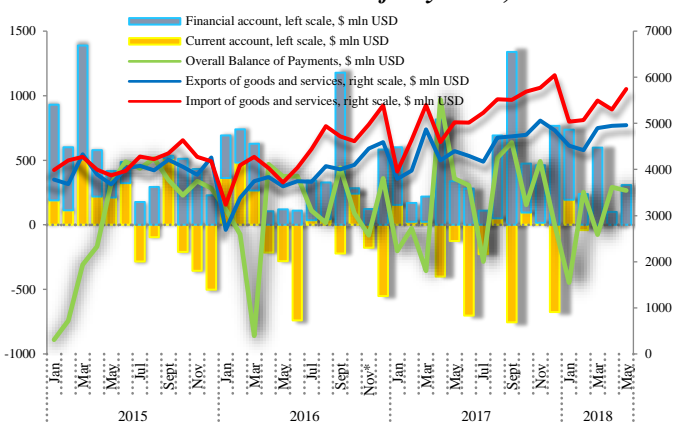


Source: The NBU, The Bleyzer Foundation

### International Trade and Capital

In May 2018 the current account of the balance of payments had a small deficit of USD 41 million. Significant growth of the primary & secondary net income surpluses of USD 419 million and USD 326 million, partly compensated a large imbalance of USD 913 million in the merchandise trade account. The main reason for the merchandise trade deficit was a slower growth of goods exports (3.2% yoy to USD 3.6 billion) than goods import (which increased by 15.5% yoy to USD 4.6 billion).

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



Source: NBU, The Bleyzer Foundation

On the merchandise export side, the highest growth took place in exports of chemicals goods with a 49.2% yoy growth; metals products, which expanded by 30.2% yoy; and wood products, which increased by 25.9% yoy. Similarly, exports of industrial goods grew by 17.8% yoy, mineral products increased by 12.9% yoy, and machinery & equipment, by 11.4% yoy.

On the import side, Ukraine's merchandised import increased in all product groups of products, as follows: mineral products, 12.9% yoy; machinery & equipment, 17.8% yoy; metals goods, 20.4% yoy; chemicals, 10.8% yoy; industrial goods, 16.8% yoy; agricultural products, 22.7% yoy; and timber & wood products, 16.8% yoy.

With regard to the geographical distribution of the merchandised trade of Ukraine, in January-May 2018 the largest deficit of trade turnover was with the Russian Federation, which grew by 73% yoy, or USD -803 million, to USD

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2 billion. During this period, imports from Russia increased by 28.7% yoy (to USD 3.2 billion) while exports fell by 7.2% yoy (to USD 1.3 billion). On the other hand, the highest growth of trade turnover took place with Europe, which increased by 14.4% yoy (to USD 15.2 billion), with export and import growth of 20.7% yoy and 9.9% yoy, respectively. Although from a low base, the largest rate of trade growth was with the US, with 37.4% yoy (USD 600 million) growth in exports and 7.3% yoy (USD 1.5 billion) growth in imports, in January-May 2018.

Regarding the financial account of Ukraine, financial inflows amounted USD 307 million in May 2018, mainly caused by net private inflows (USD 420 million), while the outflows of the public-sector were due to debt repayments (USD 113 million). Ukraine had to repay IMF debt of USD 368 million in May 2018. Therefore, from the beginning of the year the accumulated amount of repayments to the IMF reached USD 908 million. Foreign direct investments net inflows reached USD 150 million, 75% of which was sent to the banking system.

The overall consolidated surplus of the balance of payments of Ukraine amounted USD 266 million, in May 2018. At the end of June 1, the volume of international reserves amounted USD 18.2 billion which provides import financing for of the future period within 3.2 months.

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