

**April 2015**
**Oleg Ustenko, Djulia Segura, Valentyn Povrozhnyuk  
 Edilberto L. Segura**
**Executive Summary**

- ❖ Despite the Minsk II agreement reached in February 2015, Russian-backed terrorists continued attacks in Donetsk and Lugansk regions, particularly near the city of Mariupol.
- ❖ Recently there have been terrorist acts in the cities of Kharkiv and Odessa.
- ❖ The Ukrainian government has started implementation of major structural economic reforms agreed upon with the IMF Extended Fund Facility of USD 17.5 billion, of which USD 5 billion was disbursed in March.
- ❖ During January-March 2015, GDP continued to decline, with industrial output dropping by 21.4% yoy in March, and with major declines in Eastern Ukraine.
- ❖ The consolidated fiscal budget continues to improve, with the fiscal budget deficit expected to decline to 7.5% of GDP in 2015.
- ❖ The Pension Fund of Ukraine improved collection of pension contributions in the territories under control of Kyiv authorities and lowered its deficit by almost one-third in 2014.
- ❖ The upward trend of consumer inflation continued in March 2015, with consumer prices reaching 45.8% yoy during the month.
- ❖ Ukrainian banks sustained high losses in January-March 2015, mostly generated by insolvent banking institutions.
- ❖ The banking sector continues to experience significant pressures, as large national currency depreciations have caused uncertainties that led to a continuation of outflows of bank deposits.
- ❖ Thanks to IMF lending and NBU administrative measures, the Hryvnia exchange rate stabilized at around 23 UAH/USD and is expected to remain around 25 UAH/USD during 2015.
- ❖ Ukraine's balance of payments is improving, with the current account deficit for 2015 expected to be only 1.2% of GDP.
- ❖ With a low current account deficit and international financial support, the level of international reserves of the NBU is expected to increase to USD 13 billion by the end of the year.
- ❖ The Ukrainian government has started negotiations with foreign creditors on Eurobond restructuring.

<b>Forecast of Main Macroeconomic Indicators for 2014-2015</b>	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015f</b>
<b>GDP, \$ billion</b>	163.4	176.6	182.0	127.4	77.2
<b>Real GDP Growth, % yoy</b>	5.2	0.2	0.0	-6.8	-5.0
<b>Private Consumption, real growth, % yoy</b>	15.0	11.7	7.8	-9.6	-8.0
<b>Fiscal Balance, incl. Naftogaz and Pension Fund, % of GDP</b>	-4.3	-6.0	-6.5	-11.7	-7.5
<b>Public Debt, % of GDP</b>	36.3	36.6	40.5	72.0	94.0
<b>Consumer Inflation, eop, % yoy</b>	4.6	-0.2	0.5	24.9	30.0
<b>Hryvnia Exchange Rate per USD, eop</b>	8.0	8.0	8.0	15.8	25.0
<b>Current Account Balance, % of GDP</b>	-6.3	-8.1	-9.0	-4.1	-1.2
<b>FDI (\$ billion)</b>	7.0	6.6	3.3	0.2	0.5
<b>International Reserves (\$ billion)</b>	31.8	24.5	20.4	7.5	13.0
<b>External Debt (\$ billion)</b>	126.2	135.1	142.5	135.0	153.0

**Political and Stabilization Developments**

Despite the Minsk II agreement reached in February 2015, Russian backed separatists continue attacks in Donetsk and Lugansk, particularly near the city of Mariupol. Recently there have been terrorist acts in the cities of Kharkiv and Odessa. These incidents cast some doubts on the sustainability of the Minsk II peace agreement. Nevertheless, Ukraine is actively using the ceasefire agreement to free those Ukrainian soldiers who are currently imprisoned by

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rebels. Ukrainian authorities have intensified their efforts in seeking support from the West. As a result, there have been some supplies of non-lethal equipment from the USA, Canada and some EU countries. In addition, the United States is providing a training program for Ukrainian soldiers in the Lviv region. The Ukrainian Security Service has significantly increased its efficiency in preventing terroristic attacks. Nevertheless, there have been recent terrorist acts in the cities of Kharkiv and Odessa.

The Ukrainian authorities have reconfirmed their commitment to move forward with the economic reform agenda agreed upon while forming a parliamentary coalition in late 2014. This agenda has now been reflected in the March agreement with the IMF. The main reforms to be implemented include anti-corruption measures to protect business from abuse of power by officials; improvements in the business legal environment and the judicial/court system to ensure just and unbiased judgments; further business de-regulation measures to minimize red tape and bribes; energy sector reform to eliminate tariff cross-subsidization, reduction of Naftogaz deficits and promotion of energy self-sufficiency; reform of public administration, including public procurement reform, decentralization, local government reform and reform of the tax system; improvements in corporate and public governance that would protect ownership rights; and measures to restore the health of the financial sector.

The government has already disclosed key elements of these reforms: the head of the new Anti-Corruption Bureau has been appointed; the number of taxes will be reduced from 22 to 11; a draft law on business deregulation has been prepared and submitted to the Verkhovna Rada; the number of agencies having controlling functions will be decreased from 56 to 27; starting in April 2015, tariffs for energy, including natural gas and electricity, will be increased in stages until subsidies are eliminated by 2017, e-government practices are expected to be introduced in all agencies, etc. Furthermore, the government has made clear that fighting corruption will be the number one priority. Accordingly, in April there were several arrests of corrupt Ukrainian government officials. This news was widely circulated in the local media and had a positive demonstrative effect.

President Poroshenko dismissed by Presidential decree the controversial governor of the Dnipropetrovsk oblast. The ex-governor was trying to keep control over some state enterprises in the energy sector. This step signals that Ukrainian authorities are serious about separating business interests from government activities.

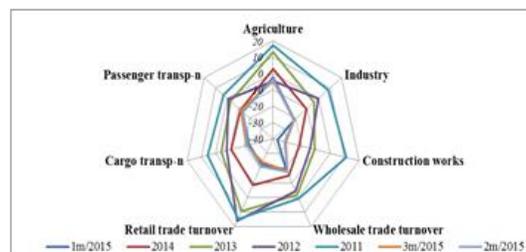
### Economic Growth

According to revised estimates of the State Statistics Committee, Ukraine's real GDP declined by 6.8% yoy in 2014. On the expenditure side of GDP, the major drop occurred in private investments, which declined by 29.2% yoy, followed by a drop of 14.5% in exports, and a decline of 9.6% in private consumption. Government consumption declined by only 0.6%. Imports declined by 22.1%, thus helping the country reduce its current account deficit.

On the production side of GDP, in 2014 positive rates of growth were shown in agriculture (2.9% yoy), public administration, defense and compulsory social security (2.6% yoy), and human health and social work activities (3.9% yoy). All other major production sectors experienced declines in output as follows: construction by -19.9%, mining and quarrying by -14.2%, manufacturing by -12%, and utilities by 10.0%.

Statistics also indicate that the major causes of the drop in GDP in 2014 were the economic and military hostilities undertaken by Russia in Eastern Ukraine. The separatist area represents only 4% of Ukraine, but it traditionally contributed a large share of its economic output: 14% of exports, 12% of industry, and 9% of GDP. Due to the hostilities, exports declined by about 22% between 2012 and 2014. As exports represent about 45% of GDP, GDP

**Economic Performance of Ukraine, by Sectors, % yoy**



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

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dropped by 6.8% in 2014. This led to devaluation of the Hryvnia (from 8 to 24 UAH/\$ in 2014-15), an increase in inflation (to 25% as the end of 2014), an increase in the unemployment rate (to 9% at the end of 2014), and problems in the country's financial sector (due to deposit withdrawals caused in turn by lack of confidence). All these factors led to declines in private consumption and investments. The good news is that trade with Russia's common market has probably already declined as much as it could. Exports to Russia, Kazakhstan and Belarus represented 32% of Ukrainian exports in 2012, but they declined to 23% in 2014 and to 12% in January-February 2015. Because of this, we expect that the declines in GDP will bottom out in the second half of 2015, with GDP declining by 5% during the entire year. Positive rates of growth should be feasible in 2016. These positive future scenarios are based on several reasons. First, as noted earlier, the negative statistical base effect of trade with Russia in real sector industries is diminishing. Second, the situation in the foreign exchange market has now stabilized. Third, the conflict in Eastern Ukraine now appears to be a "frozen" conflict signaling to investors that it will not spread to other territories of the country. And last but not least, approval of the new EFF Program by the IMF -- and the fact that the Fund is mostly satisfied with reforms in Ukraine -- both improve the financial stance of the country and create preconditions for the return of investors.

Future Ukrainian growth beyond 2015 will also depend on the ability of the country to attract large foreign investments and diversify exports. This in turn will require major improvements in Ukraine's business climate. Following the approval of the IMF Program in March 2015, the government has started the implementation of structural reforms to deal with deep-seated distortions in the economy and restart economic growth, as indicated earlier.

Over the next few years, these reforms should help Ukraine achieve sustainable rates of growth. But in the meantime, during the first quarter of 2015, the economy continued to reflect the effects of the hostilities in the East of the country with a sluggish recovery of domestic demand and exports, and uncertainties on investments. Estimates of the NBU indicate that GDP declined by 15% yoy in January-March 2015. During this period, industrial production declined by 21.4% yoy, pressed down by output reductions in the export-oriented metallurgical sector (-26% yoy), the chemicals sector (-22.6% yoy) and machinery (-21.6% yoy), all sectors for which Russia is the major market. All sectors of industrial production showed output declines. Due to output contraction in metallurgy, production of coking coal also went down by 51.9% yoy in January-March 2015. The reduction of Ukraine's foreign trade also led to a 21.5% yoy reduction in cargo transportation turnover. Retail trade turnover fell by 23.9% yoy in January-March. This reduction in retail trade was driven by a reduction of 17% yoy in real wages in January-February 2015. Agriculture, which was the main sector demonstrating positive growth in 2014, was also affected by the hostilities and general economic conditions in Q1 2015. Since agriculture is highly dependent on imported goods for production (i.e., seeds,

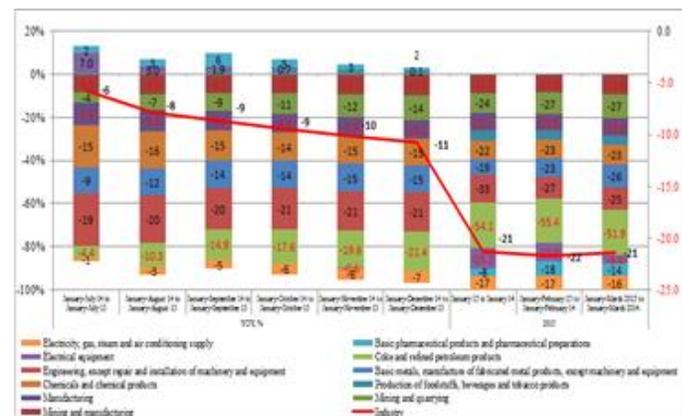
Real Sector Indicators of Ukraine, % yoy

	2015 3m*	2014	2013	2012	2011	2010
<b>Agriculture</b>	-4.7	2.8	13.3	-4.5	17.5	-1.5
<b>Industry</b>	-21.4	-10.7	-4.3	-1.8	7.6	11.2
<b>Construction works</b>	-31.3	-21.7	-11.1	-14	11.1	-5.4
<b>Domestic trade, turnover</b>						
Wholesale trade	-17.7	-15	-2	-4.4	0.6	0.4
Retail trade	-23.9	-8.6	9.5	15.9	14.7	9.8
<b>Transportation, turnover</b>						
Cargo	-21.5	-10.8	-3.9	-7.6	5.7	6.4
Passenger	-11.9	-11.7	-2.9	-1.2	3.3	-0.2

\*Excluding Crimea

Source: State Statistical Service of Ukraine, The Bleyzer Foundation

Monthly Output Production by Select Industries, % yoy



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

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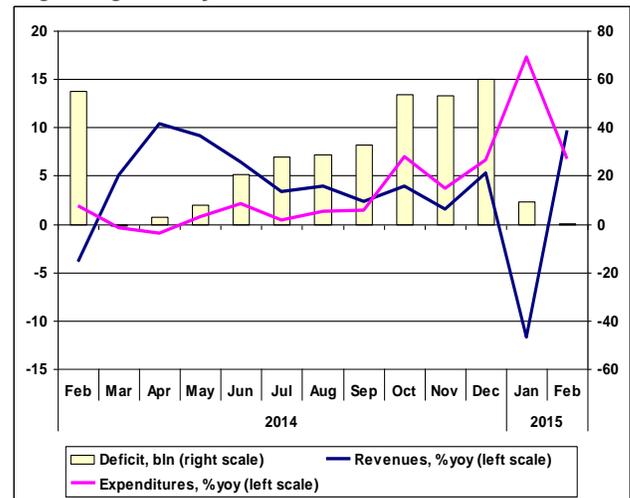
fuel, most fertilizers are imported), the production cost in the sector significantly increased in 2015 and especially after the sharp Hryvnia depreciation in February. As a result, the sector observed negative growth at the beginning of the year, which turned positive only in March (on a month-over-month basis). For the entire Q1 2015, agricultural output declined by 4.7% yoy. The construction sector suffered from both higher production costs -- because of the high share of imported materials in production -- and a significant drop in demand as real incomes of both business and population shrank, making real estate purchases mostly unaffordable. Therefore, the construction sector posted a decline of 31.3% yoy during the first three months of the year.

### Fiscal Policy

The depreciation of the Hryvnia and its consequent inflationary process have had positive impacts on the execution of the fiscal budget. These processes helped increase consolidated budget revenues, while growth of expenditures was restricted by austerity measures that contained wage costs.

As we reported previously, the consolidated budget deficit amounted to UAH 272.0 billion at the end of February 2015, which was an almost 90% decline compared to the deficit at the end of January. The decrease in the deficit was caused by high 9.7% yoy growth in consolidated budget revenues, which was higher than the growth in the consolidated budget expenditures of 6.7% yoy. More detailed analysis showed that most of the increases in the budget revenues were the result of the 50% depreciation of the national currency in February and new excise taxes. This can be seen from the data on the increases of certain budget revenues. In particular, the sharpest increases in revenues were registered for VAT on goods imported into Ukraine (by 74.5% yoy to UAH 17.595 billion), excise taxes on goods imported to Ukraine (by 5.4 times to UAH 3.121 billion), import duties (by 71.5% yoy to UAH 2.215 billion), and excise taxes on goods produced in Ukraine (by 34.1% yoy to UAH 4.7400 billion). The latter is related to a raise in excise taxes introduced by amendments to the Tax Code at the end of 2014, while all the other increases are directly related to the depreciation of the Hryvnia. Growth in other major budget revenues was much more moderate, while corporate profit tax receipts further declined (by 36.4% yoy to UAH 4.8430 billion).

### Dynamics of consolidated budget components from the beginning of the year



Source: The Ministry of Finance of Ukraine, The Bleyzer Foundation

As for consolidated budget expenditures, their growth continues to be driven by increased spending on state debt service and by higher defense spending. In particular, expenditures on state debt service more than doubled to UAH 12.236 billion in year-over-year terms in January-February 2015, which was also to a large extent related to Hryvnia depreciation. Similar developments were observed in defense expenditures, which increased 2.2 times to UAH 4.071 billion. At the same time, these increases were partially offset by declines in social expenditures associated with austerity measures. Social security and healthcare expenditures posted identical 8.1% yoy declines to UAH 13.605 billion and UAH 6.685 billion, respectively. Expenditures on education dropped 5.9% yoy to UAH 13.605 billion. The sharpest decline was observed in expenditures on housing and utilities sector at 69.0% yoy. However, this decline was due in part to a statistical base effect, as the correspondent expenditures for January-February 2014 included UAH 1.65 billion of budget transfers to local budgets to repay arrears on compensation of the difference between existing tariffs and actual cost of provided services. In January-February 2015, such transfers were not provided. At

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the same time, amendments to the law on the state budget of March 2<sup>nd</sup>, 2015 foresee annual transfer to local budgets for the mentioned purposes of UAH 2.9 billion. Transfers to the Pension Fund of Ukraine amounted to UAH 12.55 billion in January-February 2015, which is a 35.6% yoy decline and reflects cuts in special pensions.

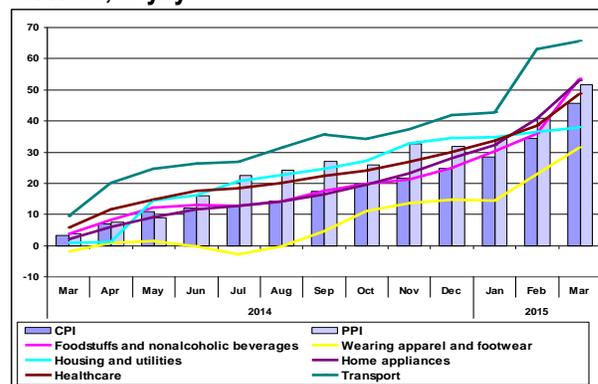
The preliminary data for budget revenues in January-March 2015 shows that the trend of rapid increases in consolidated budget revenues continued and even accelerated. In particular, the increase in the mentioned expenditures totaled 25% yoy in the first quarter of 2015 (9.7% yoy in January-February 2015). Growth in expenditures remained much slower at 12.9% yoy. As a result, the consolidated budget deficit of UAH 272 million turned into a UAH 13.97 billion surplus. There is, however, a high probability that most of the increase in revenues was again the result of both depreciation and inflation. The latter accelerated in March on the back of the population's panic purchases, which were caused by depreciation of the UAH/USD exchange rate in February and continued even after the Hryvnia recovered a bit.

The Pension Fund of Ukraine published its budget execution report for 2014 on March 30<sup>th</sup>, 2015. The report shows some improvements in Pension Fund finances. In particular, the revenue target was missed by only 2.3%, or UAH 5.798 billion. In particular, the own-revenues plan was executed by 99.4% (UAH 168.328 billion). Taking into account the fact that the Fund did not receive UAH 5.077 billion from the occupied territories of Donetsk and Lugansk oblasts, missing the revenue target by only UAH 1.046 billion is positive and reflects improvements in revenue collection in the rest of the country. Transfers from the state budget were 7.2% lower than planned at UAH 75.814 billion. Total revenues of the Fund, including the opening cash balance and outstanding loan from the single treasury account to cover cash gaps of UAH 969 million, amounted to UAH 245.245 billion. As for expenditures, the actual was 2.2% lower than planned at UAH 243.478 billion. This happened because of the illegal annexation of Crimea by Russia and temporary occupation of some territories in Donetsk and Lugansk oblasts due to which Ukrainian authorities stopped payment of pensions in the territories beyond their control. In particular, expenditures of the Fund financed directly from the state budget reached UAH 50.957 billion or just 89% of the planned amount. Those expenditures include pension payments to people who were or still are employed in underground mining and in metallurgy. At the same time, most Ukrainian coal mines (60 out of 95) are situated in the territories that are occupied in Donbass. There are also several large metallurgical plants there. The plan of expenditures financed at the expense of own receipts was executed by 100.4%. The deficit of the Pension Fund of Ukraine for 2014 totaled UAH 14.683 billion, which is a significant improvement compared to UAH 21.8 billion in 2013. The report also contains a detailed structure of the Fund's budget for 2015. Total revenues are planned at UAH 236.124 billion, including UAH 172.457 billion of own receipts and UAH 61.868 billion from the state budget. Expenditures of the Fund are planned at UAH 253.399 billion, including UAH 198.623 billion of expenditures to be financed from own receipts and UAH 54.698 billion of expenditures to be financed from the state budget. The deficit of the Pension Fund is planned at UAH 19 billion in 2015.

### Monetary Policy

**Inflation.** Consumer prices grew at an accelerated rate in March. Total CPI accelerated by 12.3 percentage points to 45.8% yoy on the back of faster growth in all price indexes. On the one hand, the Hryvnia depreciation impact on prices diminished as administrative measures of the NBU led to appreciation of the Hryvnia starting at the end of February. On the other hand, sharp growth in consumer demand caused by February's depreciation continued in March fueling consumer price growth. Significant acceleration in growth of prices was observed for foods, wearing apparel and footwear, home

### 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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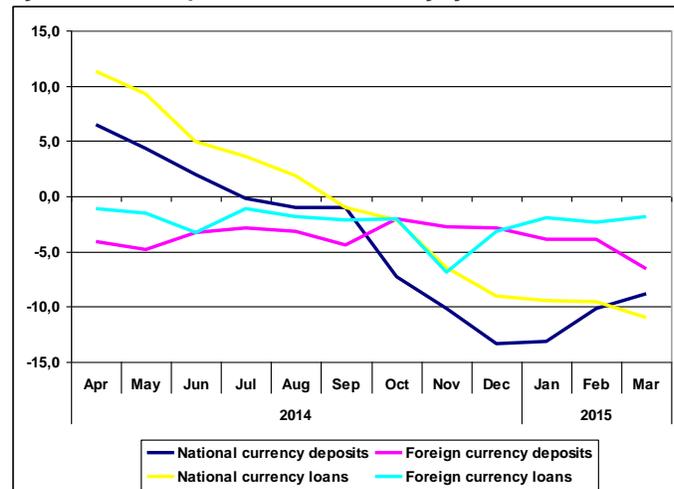
appliances, healthcare, leisure, and restaurants and hotels. Acceleration of growth in food prices in general was to a large extent stimulated by faster growth in prices of imported goods (i.e. fish and fish products, fruits) and goods with long shelf life (i.e. sugar, pasta, and sunflower oil). Growth of prices of bread and bread products was due to direct administrative decisions to increase administered prices of socially important types of bread. These increases were needed because of sharp increases in the cost of production due to Hryvnia depreciation and inflation. The only food product observing deceleration in inflation was eggs. The growth in egg prices decelerated by almost 30 percentage points, to 50.6% yoy in March. Acceleration in growth of prices of other goods was mostly related to both depreciation due to high share of imports and due to a spike in demand as those are goods people usually purchase to invest their shrinking real incomes. As for services, prices in the leisure sector and restaurants and hotels are closely tied to the US dollar. In particular, leisure services depend on prices of audio, video, photo devices and information processing equipment. All those goods are mostly imported and observed sharp increases in prices due to Hryvnia depreciation (by 12.2% mom solely in March).

Further inflation dynamics will be determined by factors with opposite impact on prices. On the one hand, the planned raise in administered prices and tariffs and lagged price effects will impose upward pressure on prices, which significantly increases risks of surpassing the target level for consumer inflation. On the other hand, there are factors that will slow down growth in prices. Among these is the diminishing impact of past depreciation and likely future Hryvnia stability. The above-mentioned increase of administered prices and tariffs will force people to save and reduce purchases of durables. Tight fiscal and monetary policy will also restrain growth of prices. In order to continue stabilization in the foreign exchange market, which improve both depreciation and inflation expectations, and continue tight monetary policy the NBU decided to leave the policy rate unchanged at 30%. Members of the Monetary Policy Committee of the NBU expect that the risk to national currency stability will diminish in the nearest future in the absence of external shocks. Then the regulator may return to the issue of lowering the policy rate and transfer to monetary policy softening.

Our forecast for inflation for 2015 remains unchanged for now at 30% yoy; it will be revised upwards in case inflation does not decelerate next month.

**Banking Sector.** Ukraine's difficult economic conditions had a negative impact on the profits of banks. According to NBU data, losses of Ukrainian banks totaled UAH 80.9 billion in January-March 2015, as expenditures were two times higher than revenues (UAH 158.403 billion against UAH 77.511 billion). 80% of losses were generated by insolvent banks. In particular, Nadra, Delta Bank, and Imexbank accumulated together UAH 60 billion of losses. Losses of the banks were the result of high allowance for potential losses on loans. The mentioned allowance increased by 7.2 times to UAH 114.312 billion in January-March compared to the corresponding

Dynamics of Deposits and Loans, % yoy



Source: The National Bank of Ukraine, The Bleyzer Foundation

time period last year. This was equal to 72.2% of total banking sector expenditures over the reporting period. As the forex market showed signs of stabilization in March, the pace of increases in allowances decelerated. Furthermore, the NBU introduced several measures to stabilize the banking system and clear it from mala fide banks. In particular, the NBU adopted unified rules for internal controls in order to improve banking risk management systems. Banks are obliged to properly assess risks of non-fulfillment of liabilities by their counterpartents and create reserves to fully

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cover possible losses. Banks with violations of any standards or benchmarks have to develop and submit to the regulator a detailed plan of measures aimed at correction of all violations and consider possible ways for additional capitalization and for improvement of their assets.

Continued outflow of deposits is hindering the recovery of the banking system. Deposits in national currency posted a 2.0% mom decline while foreign currency deposits denominated in dollars saw a 7.4% mom decline. As before, outflow of private persons' deposits was faster than the outflow of business deposits. On the positive side was the further deceleration in the decline of national currency deposits in year-over-year terms by 1.4 percentage points to 8.8%. At the same time, the pace of decline in foreign currency deposits denominated in dollars remained almost unchanged at 36.6% yoy. The NBU continued provision of financial assistance to banks to resolve their liquidity problems related to outflow of deposits in March. The amount of funds provided to 24 banks during the month amounted to UAH 13.871 billion. More than half of the amount (UAH 7.719 billion) was provided in the form of overnight loans. 15 banks received loans with maturity of up to 90/360 days in the amount of UAH 3.24 billion. Four banks received loans under the financial rehabilitation program totaling UAH 2.913 billion.

Outflows of bank loans also continued in March. Moreover, the outflow of national currency loans accelerated by 1.1 percentage points to 2.8% mom due to faster decline in medium- and long-term loans, while the pace of decline in foreign currency loans decelerated by 0.5 percentage points to 1.9% mom, as a faster decline in long-term loans was offset by increases in short- and medium-term loans. As a result of the mentioned monthly developments, the decline in the national currency loans accelerated from 9.5% yoy in February to 11.0% yoy in March. Similar to year-over-year dynamics in the foreign exchange deposits, the decline in the foreign exchange loans sustained little change being around 26% yoy.

**Hryvnia Exchange Rate.** The situation on the forex market was stable for most of April. However, stabilization was achieved thanks to administrative measures of the NBU and arbitrary elimination of requests for USD purchases, as was done in the previous month. Despite repeated statements of the NBU officials about stabilization in the forex market and easing of administrative restrictions, the regulator actually did very little in this respect. The only notable easing of restrictions took place on April 10<sup>th</sup> when the letter of credit payment method was canceled for operations above USD 0.5 million on import contracts for some essential products. The list of those products includes oil, gasoline, diesel fuel, medical goods for hemodialysis, medications for oncology patients, etc. Most of the time, the NBU announced its interventions early at the beginning of the trading session signaling the corridor within which the exchange rate was supposed to fluctuate during the day. When the regulator had not made any interventions, several systemic banks (but usually Privatbank) tried to step into its shoes and regulate the market by playing with dollar bids and offers. As a result, the exchange rate fluctuated only by 0.1-0.2 UAH/USD a day. At the same time, the exchange rate appreciated by around 2.5 UAH/USD during the week prior to Orthodox Easter. However, appreciation of the Hryvnia prior to major holidays is quite common as Hryvnia expenditures by the population increase. On the other hand, this appreciation was almost fully offset later on. Taking into account many holidays in May, the exchange rate may appreciate again to a level close to 20 UAH/USD.

We forecast that the exchange rate will fluctuate around 25 UAH/USD in the second half of the year because under a base scenario, foreign exchange supply and demand may be in rough balance. On the one hand, administrative measures are contributing to a further build-up of deferred demand for USD, which will impose pressure on the Hryvnia after the regulator lifts administrative restrictions in accordance with its commitments to the IMF. But, on the other hand, the foreign exchange requirements for the current account of the balance of payments are likely to be limited, as exports are outpacing imports. The financial account of the balance of payments may be balanced if the IMF continues its program based on satisfactory progress in structural reforms, and the ongoing negotiations to restructure foreign debt are successful. These negotiations are likely to be successful, as the government has no other option but to offer restructuring terms that would be satisfactory to its creditors.

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**April 2015**Oleg Ustenko, Djudia Segura, Valentyn Povroznyuk  
Edilberto L. Segura**International Trade and Capital**

During January-February 2015, according to data of the State Statistics Committee, Ukraine's balance of merchandise trade was positive, with a surplus of USD 106 million (compared with a merchandise trade deficit of USD 467 million for the entire 2014). During the first two months of the year, exports of goods reached USD 5,973 million, whereas imports of goods amounted to USD 5,866 million. As a result, the deficit in Ukraine's current account of the balance-of-payments has practically disappeared. For 2015 as a whole, the current account deficit is not likely to exceed 1.2% of GDP.

The improvement in Ukraine's current account took place despite the fact that merchandise exports in January-February 2015 were 33.7% lower than in the corresponding period in 2014. The improvement was due to the fact that during the same period, merchandise imports declined at a faster pace of 37% compared to the previous year. In January-February 2015, the major declines in exports took place in goods that traditionally had been shipped to Russia, including transport equipment (-72.6% yoy), machinery and equipment (-38.9%), ferrous metals (-40.8%), and mineral products (-57.2%). But export declines took place in almost all other categories, though at lower rates of decline, including agriculture (-13.3%), processed food products (-20.7%), and live animals (-32%). On the import side, due to low domestic demand, in January-February imports of foodstuffs declined by 44% on a year-over-year terms, while imports of machinery and transport equipment declined by 45% yoy.

According to preliminary data released by the State Fiscal Service of Ukraine, the improvements in the current account continued during March, with merchandise exports reaching USD 9.5 billion during January-March and imports USD 9.2 billion during the same period. On this basis, the merchandise trade surplus for the first quarter of the year amounted to USD 300 million. With reference to the financial account of the balance of payments, the outflows of capital in January-March 2015 reached USD 1,326 million due to higher loan repayments. But the IMF loans to the government (USD 2,519 million) and to the NBU (USD 2,176 million) compensated for these outflows and permitted a build-up of international reserves to about USD 10 billion.

The IMF program continues to be the main financial anchor for Ukraine. According to the IMF agreement, the Ukrainian government has started negotiations to restructure about USD 23 billion under 29 Eurobonds and loans outstanding. This restructuring is expected to provide a relief in debt service of about USD 15 billion in funding during the next four years (thanks principally to maturity extensions), reduce public debt as a share of GDP to below 71% by 2020, and keep the government's gross financing needs to an average of 10% of GDP between 2019 and 2025. The most risky part of this on-going negotiation is a USD 3 billion debt to Russia, which was placed through the Irish Stock Exchange in December 2013 and is due at the end of 2015. The Ministry of Finance is eager to conclude negotiations with bondholders before the next IMF review, which is scheduled for June.

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