

February 2020

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### Executive Summary

- ❖ On February 18<sup>th</sup>, Russian-led forces in eastern Ukraine launched several intense attacks, killing one Ukrainian soldier and injuring four others. President Zelenskyy said that this offensive was an attempt to disrupt the peace process and will not change his plan to end the war.
- ❖ During January, the Rada continued work on legislation related to the introduction of land market reform. It is now expected that the legislation will be voted at the end of March. It envisages that all government land will be privatized and the moratorium for land sale will be removed. The current draft assumes that the maximum land lot will be 10,000 hectares and foreigners will not be allowed to buy Ukrainian land until a special referendum.
- ❖ The IMF mission arrived to Kyiv on February 20 for “technical discussions”. A key IMF demand is Rada approval of a law to ban the return of nationalized banks to their previous owners.
- ❖ The most recent data from the State Statistics Service showed that economic growth slowed down to 1.5% yoy in the fourth quarter of 2019, which may lead to a GDP growth rate of 3.3% for 2019. The slowdown was caused by lower agricultural, industrial and energy output, and despite good performance of construction and retail trade.
- ❖ The cumulative consolidated budget deficit for 2019 was at UAH 84.3 billion or around 2.4% of GDP, which lies within the limits agreed upon with the IMF.
- ❖ Consumer inflation further decelerated in December lowering it below the medium-term target. The all items index decreased by 1.0 percentage point to 4.1% yoy, which was the lowest level since April 2014.
- ❖ Banking deposits continued to expand in December, while bank lending activities continued to be sluggish.
- ❖ During January 2020, the UAH/USD exchange rate was on the depreciatory path, depreciating by 5.7% to around 25.04 UAH/USD by the end of the month.
- ❖ In 2019, Ukraine’s current account deficit declined by 75.5% yoy to USD 1,072 million (0.7% of GDP), compared to USD 4,367 million in 2018. Ukrainian financial account net inflow amounted USD 7,005 million. Therefore, the overall consolidated surplus of the balance of payments amounted to USD 5,971 million. This surplus increased international reserve to USD 25,302 million, enough for 3.8 month 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>2019e</b>	<b>2020f</b>
<b>GDP, USD billion</b>	180	130	87	93.4	113	131	153	172
<b>Real GDP Growth, % yoy</b>	0.0	-6.6	-9.9	2.4	2.5	3.3	3.3	3.5
<b>Fiscal Balance (incl.Naftogaz/Pen Fund),% of GDP</b>	-6.5	-11.7	-2.1	-2.3	-1.4	-1.9	-2.4	-2.0
<b>Public Debt, External and Domestic, % of GDP</b>	40.4	69.4	79.1	80.9	71.8	60.9	56.0	55.0
<b>Consumer Inflation, eop, % yoy</b>	0.5	24.9	43.3	12.4	13.7	9.8	4.1	5.5
<b>NBU Key Policy Interest Rate, % eop</b>	6.5	14.0	22.0	14.0	14.5	18.0	13.5	8.6
<b>Hryvnia Exchange Rate per USD, eop</b>	8.2	15.8	24.0	27.1	28.1	27.7	23.7	26.0
<b>Current Account Balance, % of GDP</b>	-9.2	-3.5	1.8	-1.5	-2.2	-3.3	-0.7	-3.1
<b>Merchandise Exports, USD billions</b>	59	51	35	34	40	43	46	49
<b>Merchandise Imports, USD billions</b>	81	58	39	40	49	56	60	63
<b>FDI, Net Annual Inflow, USD billion</b>	4.5	0.4	3.0	3.3	2.3	2.4	2.0	2.5
<b>International Reserves, USD billion</b>	20.4	7.5	13.3	15.5	18.8	20.8	25.3	24.0
<b>Public External Debt, USD billion</b>	31.7	34.9	42.6	42.5	47.0	49.9	50.2	53.0
<b>Private External Debt, USD billion</b>	110.3	91.2	76.0	69.9	70.0	71.0	72.0	74.0

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### *Political and Reform Developments*

On February 15, President Zelenskyy participated in the Munich Security Conference. In his speech, the President showed optimism as regards to the end of the war in the east of Ukraine. “We didn't start this war. But we have to finish it. And we will. Together with you. And today Ukraine continues to consistently and steadily adhere to a peaceful, diplomatic path of settlement in accordance with the rules of international law,” Volodymyr Zelenskyy noted. However, on February 18<sup>th</sup>, Russian-led forces in eastern Ukraine launched several intense attacks, killing one Ukrainian soldier and injuring four others. President Zelenskyy said that this offensive was an attempt to disrupt the peace process and will not change his plan to end the war.

During January, the Ukrainian Parliament continued work on legislation related to the introduction of land market reform. The work of legislators from the ruling party met strong resistance from all other fractions. In fact, the strategy of those who opposed this initiative was to introduce as many as possible changes to the existing draft law to block the process. The secretariat of Verhovna Rada received more than 4,000 proposed changes. However, the ruling party decided to move forward the reform agenda. Currently, the Parliament is reviewing each proposed change. So far, around 1,000 propositions were already discussed. It is expected that the legislation will be voted at the end of March. The legislation assumes that all government land will be privatized and moratorium for land sale will be removed. The current compromise assumes that the maximum land lot will be 10,000 hectares and foreigners will not be allowed to buy Ukrainian land until a special referendum on this matter. Until this work is finished the Parliament will not consider any other legislation with the exemption of high urgency.

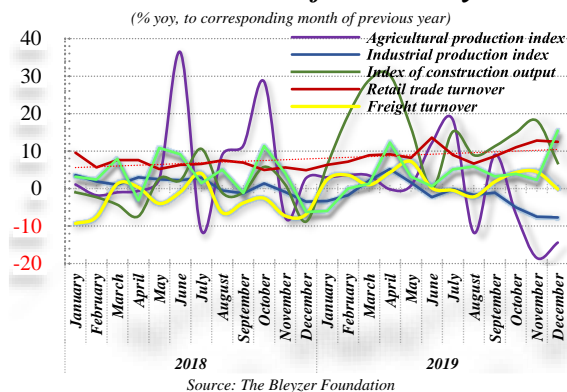
The IMF mission arrived to Kyiv on February 20 for “technical discussions”. A key IMF demand is Rada approval of a law to ban the return of nationalized banks to their previous owners. The USD 5.5 billion IMF Program has become important, since the demand for government bonds has declined substantially in recent auctions. Cooperation with the IMF is also needed to unblock support from other international financial institutions and the EU.

### *Economic Growth*

The latest information from the State Statistical Service shows that Ukraine’s economy slowed down during the last months of 2019, with GDP in Q4-2019 growing by only 1.5% yoy, compared to 4.1% yoy in Q3-2019 and 4.6% yoy in Q2-2019. The slowdown was caused by lower agricultural output due to a weak harvest, lower industrial production due mainly to lower metallurgy and machinery output, and lower energy output. As a result, GDP growth in 2019 is likely to be at about the same rate of 3.3% achieved in 2018. For the year 2019 as a whole, the best performances were shown in construction output (20% yoy), and retail trade turnover (10.5% yoy.) They were followed by passenger turnover (3.3% yoy), freight turnover (2.1% yoy), agricultural production (1.1% yoy), and industrial output (which fell by -1.8% yoy).

The latest data for December shows that the Ukraine continued to experience output decline of agricultural production and industrial performance, which fell down by 14.4% yoy and 7.7% yoy, respectively. On the other hand, the highest growth was experienced in construction output, which increased by 6.8% yoy. In addition, good results took place in retail trade turnover which improved by 12.5% yoy. Also, Ukrainian passenger (15.5% yoy)

### *Ukraine Economic Performance by Sector*



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and freight turnover (-0.1% yoy) experienced good seasonally adjusted performance. In December 2019, favorable support was encouraged by growth of average monthly wages in a nominal (16% yoy) and real salaries levels (11.3% yoy), respectively.

Concerning industrial production, in December 2019 only three sectors had output growth: chemicals (8.7% yoy); rubber and plastic products (0.6% yoy); and furniture manufacturing (2.4% yoy). Other industrial sectors had output reductions as follows: machinery & equipment (-14.5% yoy); metallurgy (-10.0% yoy); textile industry (-8.1% yoy); coke and refined petroleum (-6.8% yoy); basic pharmaceutical products (-6.7% yoy); wood products, paper and printing (-4.5% yoy); and foodstuffs, beverages and tobacco products (-2.4% yoy).

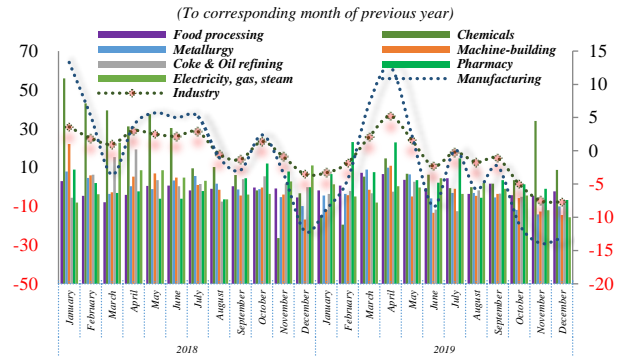
Regarding geographical distribution of industrial production, output growth was experienced in only seven regions, as follows: Odesa (12.3% yoy), Mikolayiv (9.6% yoy), Rivne (3.5% yoy), Cherkasy (2.8% yoy), Sumy (1.3% yoy), Chernihiv (1.2% yoy), Kherson (1.0% yoy). Other regions had negative industrial output growth, as follows: Zakarpattya (-30.7% yoy), Luhansk (-15% yoy), Kharkiv (-15% yoy), Kirovohrad (-14.6% yoy), Donetsk (-13% yoy), Volyn (-11.8% yoy), Dnipropetrovsk (-10.5% yoy), Ivano-Frankivsk (-10.2% yoy), Zaporizhzhya (-10% yoy), Khmelnytskyi (-8.7% yoy), Vinnytsya (-8.2% yoy), Ternopil (-7.4% yoy), Kyiv obl. (-5.9% yoy), Lviv (-4.9% yoy), Chernivtsi (-4.8% yoy), Poltava (-2.4% yoy), and Zhytomyr (-1.3% yoy).

**Fiscal Policy**

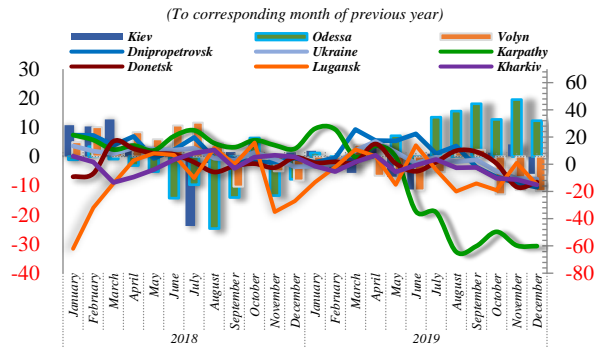
Following seasonal trends, the consolidated fiscal budget had a large deficit of UAH 77.4 billion in December. The deficit of the state budget of UAH 43.2 billion was complemented by the deficit of the local budgets of UAH 34.2 billion. The government borrowed heavily to execute the budget. Net borrowing amounted to UAH 24.1 billion. In addition, the government pumped additional UAH 46.2 billion of cash into the economy and use other instruments to enhance liquidity by UAH 7.2 billion. The cumulative consolidated budget deficit for 2019 was at UAH 84.3 billion or around 2.4% of GDP which lies within the limits agreed with the IMF.

Consolidated budget revenues were back to growth in December. Total revenues grew by 14.9% yoy thanks to growth in both tax and non-tax revenues (16.7% yoy and 11.1% yoy, respectively). Growth in both categories was ensured by early payments made by state-owned companies. The largest contribution was made by Naftogaz which made early corporate profit tax payment and also early payment of dividends. As a result, receipts from

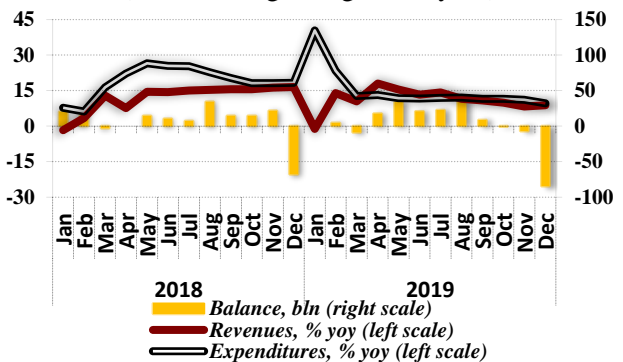
**Ukraine Industrial Production by Sectors % yoy**



**Ukraine Industrial Production by Regions % yoy**



**Dynamics of Consolidated Budget Components (from the beginning of the year)**



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corporate profit tax posted a 217.7% yoy increase and income and entrepreneurship incomes expanded 51.0% yoy. Receipts from domestic taxes on goods and services increased by 12.1% yoy mostly thanks to receipts from the VAT. VAT receipts on both domestic and imported goods returned to growth (52.8% yoy and 2.3% yoy respectively). The former expanded thanks to lower VAT reimbursements than usual. Receipts from excise taxes on domestic goods returned to growth (1.5% yoy) on the back of recently increased excise tax rates. Receipts from excise taxes on imported goods continued to decline (5.3% yoy). Personal income tax receipts further expanded at decent rate of 17.1% yoy. The cumulative consolidated budget revenues grew by 8.9% yoy in 2019.

Despite common seasonal trends, the consolidated budget revenues posted decelerated growth in December. Total expenditures increased by 1.4% yoy which was more than five times less than in November. Actually, the government stopped financing non-protected budget expenditures as a precaution in order not to exceed the consolidated budget deficit threshold agreed with the IMF. However, after additional budget payments of Naftogaz and other state-owned companies, the government resumed financing those expenditures at the end of the month. Current expenditures grew by 3.5% yoy, while capital expenditures dropped 5.1% yoy. Current transfers again posted the largest growth which almost halved to 42.9% yoy. Growth of payroll expenditures accelerated again reaching 19.9% yoy. Debt servicing expenditures returned to growth (11.8% yoy). On the other hand, expenditures on goods and services and social security expenditures posted declines of 13.6% yoy and 1.3% yoy respectively. The cumulative consolidated budget expenditures expanded by 9.6% yoy in 2019.

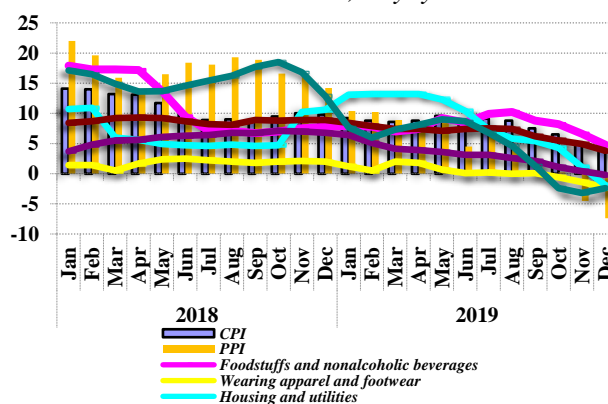
The government payments on state and guaranteed debt denominated in foreign currency decreased by almost three times in December 2019 as compared to November. The total amount of payments was at USD 220.3 million equivalent. USD 181.3 of the mentioned amount was paid in principal and servicing payments on domestic sovereign bonds denominated in foreign currency. The rest was paid on other liabilities to foreign creditors and IFIs.

### Monetary Policy

**Inflation.** Consumer inflation further decelerated in December lowering it below the medium-term target. The all items index decreased by 1.0 percentage point to 4.1% yoy, which was the lowest level since April 2014. That was the result mainly of strict monetary policy and hryvnia strengthening. Core inflation dropped 0.9 percentage points to 3.9% yoy. The government considers the mentioned levels too low as they started harming national producers. Therefore, it is planned to slightly accelerate inflation at the beginning of 2020.

All the major groups of goods and services sustained either deceleration in price growth or acceleration in price decline, except for transport. The major reason for this was hryvnia strengthening, while additional factors were the decline in the world energy prices and further expansion of whole foods supply. Prices of transport services saw deceleration of the decline to 2.4% yoy. The most significant change in price dynamics was observed for housing and utilities as their price growth dropped 3.0 percentage points from a 1.1% yoy growth to a 1.9% yoy decline. Foodstuffs and non-alcoholic beverages saw their price growth decelerating by 1.8 percentage points to 6.6% yoy, while communication services reported a 1.6 percentage point decrease in price growth to 11.8% yoy. Deceleration in price growth for other major groups and services ranged from 0.6 percent points for home appliances to 1,1 percent points for healthcare.

*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.** Both banking deposits and loans followed the trends observed last month. High interest rates led to further expansion of deposits in both households and corporate sectors and in both national and foreign currencies. At the same time, lending activity further curtailed. The decline in corporate loans slightly accelerated, while growth of household loans remained above 20% yoy despite some deceleration thanks to consumer loans. Foreign currency loans continued to decline in both corporate and household sectors.

The monetary base expanded at accelerated rate of 6.9% mom, which led to faster year-over-year growth of 9.6%. The situation with money supply was similar, as its monthly growth accelerated to 7.7% and year-over-year growth to 12.3%. This was the result of increased budget expenditures at the end of the month.

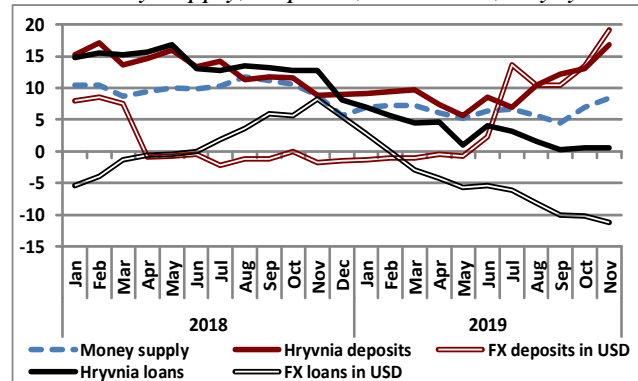
**Hryvnia Exchange Rate.** The UAH/USD exchange rate was on the depreciatory path in January 2020. Deferred demand due to long holidays at the beginning of the year, thin market because of low business activities, and increased hryvnia resources thanks to large VAT reimbursements and repayments on domestic sovereign bonds denominated in hryvnia were the reasons for depreciation. Overall, the exchange rate depreciated by 5.7% to around 25.04 UAH/USD.

**International Trade and Capital**

In 2019, Ukraine’s current account deficit declined by 75.5% yoy to USD 1,072 million (0.7% of GDP), compared to USD 4,367 million in 2018. The decline of the current account deficit during 2019 was due to higher growth in exports of goods and services of 7.2% (to USD 63,380 million), than an increase in imports of 7.1% (USD 75,497 million). Regarding merchandise, exports of goods grew by 6.4% to USD 46,115 million, while goods imports increased by 7.1% yoy to USD 60,062 million. As a result, during the year, the net merchandise trade deficit increased by 9.7% yoy (USD 13,947 million), while the net services surplus expanded by 35.9% yoy (USD 1,830 million). In addition, net primary and secondary income grew by 42.4% yoy (USD 4,769 million) and 71.9% yoy (USD 6,276 million).

During 2019, the major growth of exported goods took place in agricultural products (19% yoy),

Money Supply, Deposits, and Loans, % yoy



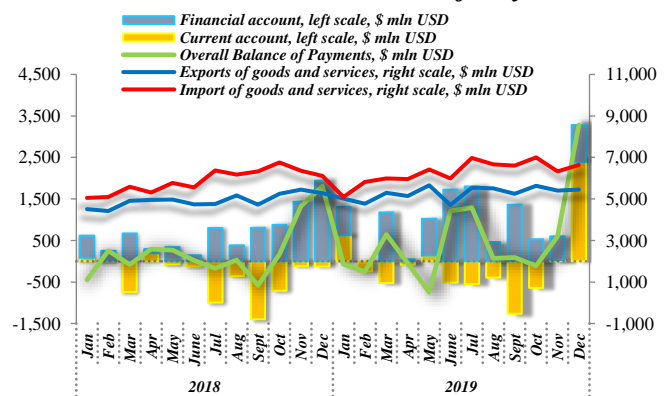
Source: The NBU, The Bleyzer Foundation

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



Source: The NBU, The Bleyzer Foundation

Ukraine's External Balance of Payments



Source: NBU, the Bleyzer Foundation

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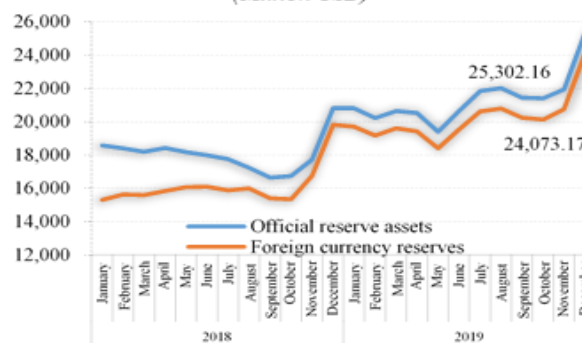
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machinery and equipment (13.6% yoy), mineral products (13.5% yoy), industrial goods (7.4% yoy) and goods from informal trade (3.6% yoy). At the same time, declines of exported goods were shown in ferrous and nonferrous metals (-12.3% yoy), timber and wood products (-9.4% yoy) and chemicals goods (-8.8% yoy).

In 2019, the largest increase in merchandised export share was in agricultural product (to 48% share, from 42.9% in 2018), mineral goods (9.6% from 9%), machinery and equipment (7.4% from 6.9%). Other goods reduced their share of exported products, principally in chemicals (4.7% from 5.5% in 2018), ferrous and nonferrous metals (21.7% from 26.3%), timber and wood products (3.9% from 4.5%) and other informal trade goods (3.3% from 3.4%).

The highest share of growth at imported goods was in machinery and equipment (32.2% from 28.5% in 2018), agricultural products (9.5% from 9%) and industrial goods (5.2% from 4.6%). The main reductions in merchandised import share was in mineral products (21% from 24% in 2018), chemicals goods (18.1% from 18.6%), informal trade (6.1% from 6.6%), ferrous and nonferrous metals (5.9% from 6.1%), timber and wood products (2.1% from 2.4%), respectively. The largest expansion of imported goods was in machinery and equipment (21% yoy), industrial goods (20.5% yoy), agricultural goods (14% yoy), chemicals products (4.2% yoy), ferrous and nonferrous metals (2.4% yoy), in 2019. On the other side, during the year decline of merchandised imports took place in mineral goods (-7.3% yoy), timber and wood products (-5.1% yoy) and informal trade (-0.5% yoy).

**International Reserve of Ukraine**  
(Million USD)



Source: NBU, the Bleyzer Foundation

Regarding the regional distribution of merchandised trade, trade with the Russian Federation was reduced in both exports (5.7% share) and imports (11.3% share) by 13.3% yoy and 15.3% yoy, correspondingly. Ukrainian foreign trade with Europe showed expansions of export by 5% yoy (38.1% share) and imports by 10.2% yoy (41.5% share).

Ukrainian financial account net inflow amounted USD 7,005 million, sufficient to cover the current account deficit in 2019. The major support of financial account inflow was provided by foreign direct investments and portfolio investments, whose net inflow expanded by 6.1% yoy (USD 2,504 million) and 147% yoy (5,140 million), correspondingly. Therefore, the overall consolidated surplus of the balance of payments amounted to USD 5,971 million. This surplus increased international reserve to USD 25,302 million, enough for 3.8 month of imports.

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