

March 2020

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 Edilberto L. Segura

Executive Summary

- ❖ On March 4th, the Verkhovna Rada accepted the resignation of PM Honcharuk. Denis Shmygal, the Deputy Prime Minister and Minister for Development of Local Communities (a former governor of Ivano-Frankivsk Oblast and former DTEK executive), was approved by Ukraine's Parliament as the new PM.
- ❖ Due to the worldwide coronavirus pandemic, since March 15th, Ukraine has introduced quarantine measures. Many banks are closed, public transportation is reduced, many newspapers and firms have suspended work. In addition, the country's borders are closed.
- ❖ From April to December 2020, Ukraine has to repay about USD 4 billion in external loans. The recent events will make it difficult for the country to refinance these amounts in the private capital markets. Therefore, the new government is actively seeking to expand and accelerate disbursement under IMF programs.
- ❖ Economic growth in the last quarter of 2019 slowed down to 1.5% yoy. Monthly data indicates that this underperformance continued in January and February 2020. But further economic deterioration is expected, as the current worldwide coronavirus pandemic is generating severe economic slowdowns in many countries, including Ukraine. GDP is likely to decline during the first half of the year and GDP growth could be reduced to around 2% in 2020.
- ❖ Consumer inflation further decelerated to 3.2% yoy in January. However, devaluations during March and the economic slowdown caused by the coronavirus is likely to increase inflation by the end of the year.
- ❖ Banking deposits continued to expand in January, while banking lending activities continued to be sluggish.
- ❖ During March 2020, the UAH/USD exchange rate was on the depreciatory path, depreciating to around 27.75 UAH/USD by March 20.
- ❖ In January 2020, Ukraine's current account had a surplus of USD 590 million. The major source of the current account surplus was a reduction in the net foreign trade deficit to an almost balanced result of USD 6 million. Ukrainian financial account net inflow amounted USD 315 million in January. Therefore, the overall consolidated surplus of the balance of payments amounted to USD 905 million. This surplus increased international reserve to USD 25.7 billion.

Main Macroeconomic Indicators	2013	2014	2015	2016	2017	2018	2019e	2020f
<i>GDP, USD billion</i>	180	130	87	93.4	113	131	153	169
<i>Real GDP Growth, % yoy</i>	0.0	-6.6	-9.9	2.4	2.5	3.3	3.3	2.0
<i>Fiscal Balance (incl.Naftogaz/Pen Fund),% of GDP</i>	-6.5	-11.7	-2.1	-2.3	-1.4	-1.9	-2.4	-2.0
<i>Public Debt, External and Domestic, % of GDP</i>	40.4	69.4	79.1	80.9	71.8	60.9	56.0	56.0
<i>Consumer Inflation, eop, % yoy</i>	0.5	24.9	43.3	12.4	13.7	9.8	4.1	7.5
<i>NBU Key Policy Interest Rate, % eop</i>	6.5	14.0	22.0	14.0	14.5	18.0	13.5	8.6
<i>Hryvnia Exchange Rate per USD, eop</i>	8.2	15.8	24.0	27.1	28.1	27.7	23.7	28.0
<i>Current Account Balance, % of GDP</i>	-9.2	-3.5	1.8	-1.5	-2.2	-3.3	-0.7	-3.0
<i>Merchandise Exports, USD billions</i>	59	51	35	34	40	43	46	49
<i>Merchandise Imports, USD billions</i>	81	58	39	40	49	56	60	63
<i>FDI, Net Annual Inflow, USD billion</i>	4.5	0.4	3.0	3.3	2.3	2.4	2.0	2.5
<i>International Reserves, USD billion</i>	20.4	7.5	13.3	15.5	18.8	20.8	25.3	24.0
<i>Public External Debt, USD billion</i>	31.7	34.9	42.6	42.5	47.0	49.9	50.2	53.0
<i>Private External Debt, USD billion</i>	110.3	91.2	76.0	69.9	70.0	71.0	72.0	74.0

Political and Reform Developments

On March 4th, President Zelenskyy delivered an address to an extraordinary session of the Verkhovna Rada. The President pointed out that the Government of PM Oleksiy Honcharuk had made significant progress in many areas of economic development, including a decrease in inflation, reduction of the NBU base rate, fight against the shadow markets (including gambling and illegal gas stations), the beginning of the privatization of state-owned enterprises, loans to SMEs, and reduction of the role of the state in the economy. He felt, however, that this progress was insufficient to ensure an economic breakthrough and higher rates of economic growth. They did not meet the aspirations of the Ukrainian people. Therefore, PM Honcharuk submitted a request to accept his resignation.

The Verkhovna Rada accepted the resignation of PM Honcharuk. Subsequently, Denis Shmygal, the Deputy Prime Minister and Minister for Development of Local Communities (a former governor of Ivano-Frankivsk Oblast and former DTEK executive), was approved by Ukraine's Parliament as the new PM. In his speech, Mr. Shmygal gave assurances that the country would continue to reform in “a fast-track”, including the introduction of land market reform, privatization of state enterprises, creating business friendly environment and continue cooperation with IMF.

However, these Cabinet changes caused uncertainties in the business and international communities since the new Ministers are not well known and do not have a strong record of reform. Following the announcement, the yield on short Ukrainian Eurobonds increased and the Ukrainian hryvnia began to fall, forcing the National Bank of Ukraine to intervene. The new government will need to implement very fast economic and social measures to ensure that it will deepen the reform agenda.

Due to the worldwide coronavirus pandemic, since March 15th, Ukraine introduced quarantine measures. Many banks are closed, public transportation is reduced, many newspapers and firms have suspended work. In addition, the country’s borders are closed. Citizens from abroad are making their ways to the home country. The government is introducing extraordinary measures to prevent people from infection, which include supplying hospitals with the necessary equipment.

From April to December 2020, Ukraine has to repay about USD 4 billion in external loans. The recent events will make it difficult for the country to refinance these amounts in the private capital markets. Therefore, the new government is actively seeking to expand and accelerate disbursement under IMF programs.

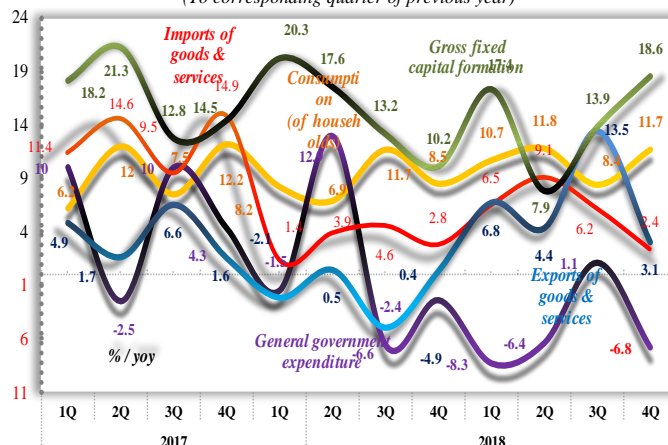
Economic Growth

The State Statistics Service of Ukraine confirmed that in the fourth quarter of 2019 real GDP grew by 1.5%. Therefore, in 2019, GDP growth reached 3.2% yoy, compared to a 3.3% yoy of the previous year 2018. During 2019, the mayor sources of economic growth were domestic demand (8.1% yoy), particularly household consumption (11.9% yoy) and gross fixed capital formation (14.2% yoy) while government expenditures experienced a significant reduction (-4.9% yoy). Net foreign trade of Ukraine showed a higher growth of merchandised exported goods (6.7% yoy), than imported products (6.3% yoy) in 2019.

Regarding the production side of GDP, in 2019 the largest expansion took place in the following areas:

GDP Growth of Ukraine, % yoy

(To corresponding quarter of previous year)



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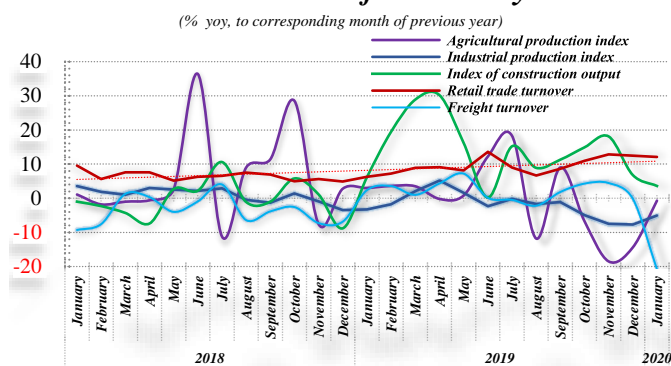
construction (23% yoy); information and communication (7.5% yoy); real estate (7.5% yoy); accommodation and food services (7.1% yoy); administrative and support service activities (6.5% yoy); public administration, defense and compulsory social security (5.9% yoy); professional, scientific and technical activities (5.6% yoy); financial and insurance activities (3.7% yoy); arts, entertainment and recreation (3.7% yoy); wholesale and retail trade (3.6% yoy); transportation and storage (3.5% yoy); human health and social work activities (2.4% yoy); agriculture, forestry and fishing (1.3% yoy); manufacturing (1% yoy), and water supply, sewerage with waste management & remediation activities (0.7% yoy). However, negative sign showed three sectors, with decline of electricity, gas, steam and air conditioning supply (-4.2% yoy); mining and quarrying (-1.5% yoy); and education (-1.3% yoy).

On January 2020, Ukraine's economic activity continued to show good performance only in construction output (3.6% yoy), retail trade turnover (12.1% yoy) and passenger transportation turnover (171.9% yoy). However, Ukrainian agriculture and industrial production fell down by -0.7% yoy and -5.1% yoy correspondingly. Within manufacturing, in January the worse performance took place in basic pharmaceuticals (-14.7% yoy), machinery and equipment (-10.5% yoy), metallurgy (-10.3% yoy), rubber, plastic and other non-metallic mineral products (-7.6% yoy), and wood products (-2.3% yoy). On the other hand, five sectors continued to recover as follows: chemical products (24.4% yoy), textile industry (3.9% yoy), coke and refined petroleum (3.8% yoy), foodstuff products (2.9% yoy), and furniture (0.2% yoy).

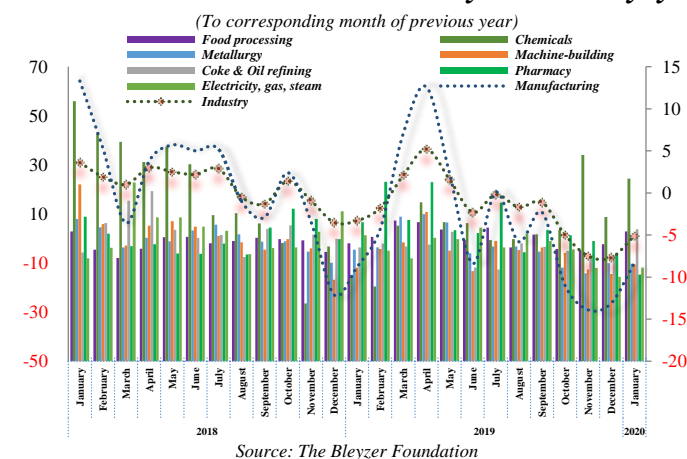
With regard to the geographical distribution of industrial output, in January 2020, the highest production growth took place in the following regions: Kherson (20.2% yoy), Kirovohrad (15.1% yoy), Lviv (7.7% yoy), Odesa (6.1% yoy), Rivne (6.0% yoy), Mikolayiv (4.0% yoy), Cherkasy (1.6% yoy), Poltava (1.1% yoy), correspondingly. Negative rates of growth took place in the following oblasts: Luhansk (-26.0% yoy), Ternopil (-15.3% yoy), Dnipropetrovsk (-13.8% yoy), Vinnytsya (-12.1% yoy), Zakarpattya (-10.7% yoy), Donetsk (-10.1% yoy), Kyiv (-9.1% yoy), Zhytomyr (-5.3% yoy), Zaporizhzhya (-5.3% yoy), Sumy (-4.5% yoy), Kyiv city (-4.5% yoy), Ivano-Frankivsk (-2.9% yoy), Kharkiv (-2.9% yoy), Volyn (-1.8% yoy), Khmelnytskyi (-1.8% yoy), Chernivtsi (-1.0% yoy), Chernihiv (-0.9% yoy),

The current coronavirus pandemic is generating severe economic slowdowns in many countries, including Ukraine. GDP is likely to decline during the first half of the year and growth could be reduced to about 2% in 2020.

Ukraine Economic Performance by Sector



Ukraine Industrial Production by Sectors % yoy



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Fiscal Policy

The consolidated fiscal budget had a deficit of UAH 3.2 billion in January. The state budget deficit of UAH 15.3 billion was partially offset by the cumulative surplus of local budgets of UAH 13.5 billion. The government financed the resulting consolidated budget deficit of UAH 3.2 billion through borrowing. Net borrowings totaled UAH 19.42 billion. At the same time, the government used its liquidity regulating instruments to reduce money supply by UAH 6.139 billion and also pumped UAH 10.379 billion in cash out of the economy.

Consolidated budget **revenues** posted a decline in January. Total revenues dropped 1.6% yoy, as a 2.8% yoy decline in tax revenues more than offset a 7.3% yoy growth in non-tax revenues. The decline in total revenues and in tax revenues in particular was the result of statistical base effect (last year, there was a temporary increase in receipts from duties on customs clearance of imported cars with temporary registration) and issues related to hryvnia strengthening (like decline in taxes on imported goods because of their lower prices in hryvnia). The later caused a decline in receipts from domestic taxes on goods and services in general, despite a 127.4% yoy growth in receipts of the VAT on domestic goods. Receipts from the excise taxes on domestic goods dropped 7.3% yoy. Non-tax revenues expanded on the back of payments of transfers of profits and dividends from state-owned companies.

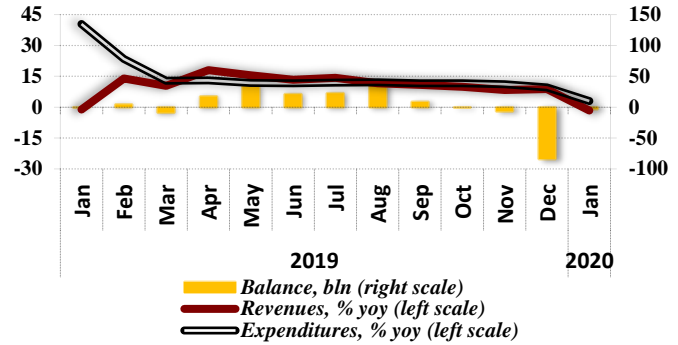
Growth of the consolidated budget **expenditures** decelerated again in January. Growth in both current and capital expenditures (by 2.8% yoy and 23.6% yoy, respectively) led to 3.0% yoy growth of total expenditures. Payroll expenditures and current transfers were the main drivers of growth (expanded by 20.5% yoy and 100.5% yoy respectively). Other major expenditures posted declines. In particular, social security expenditures decreased by 7.1% yoy, while expenditures on goods and services dropped 21.3% yoy and state debt servicing expenditures decreased by 25.7% yoy.

Government payments on state and guaranteed debt denominated in foreign currency totaled USD 656.1 million equivalent in January. USD 602.2 million of the mentioned amount were 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

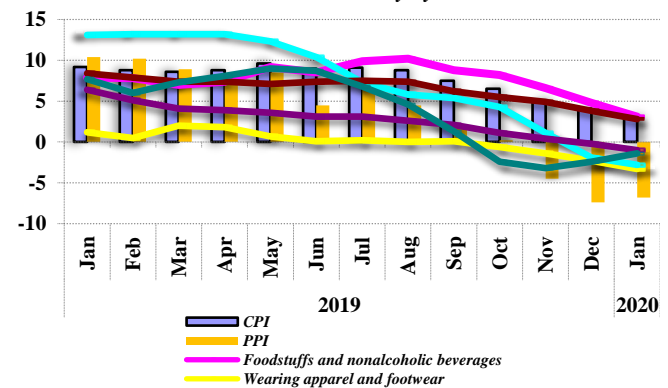
Inflation. Consumer inflation continued to decelerate in January. The all items index fell by 0.9 percentage points to 3.2% yoy. Continued deceleration in price growth was the result of hryvnia strengthening in 2019 supported by the decline in world energy prices and by the increase in supply of whole foods. The cumulative effect from the mentioned factors more than offset the influence of fast growth in consumer demand and wages. Core inflation decelerated to 3.3% yoy. All the major

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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groups of goods and services sustained either deceleration in price growth or acceleration in price decline, except for education and transport. Growth of prices in educational services remained unchanged at 13.5% yoy. The decline in transport prices decelerated to 1.4% yoy. The most significant deceleration in price growth was observed for healthcare at 1.0 percentage points to 2.8% yoy. At the same time, the fastest acceleration in price decline was observed at 1.0 percentage point for wearing apparel and footwear to 3.3% yoy.

Banking Sector. In January banking deposits continued to grow at accelerated pace despite gradual decrease of the policy rate (by 2.5 percentage points to 11% in January) thanks to growth in wages. National currency deposits grew by 21.1% yoy, while foreign currency deposits denominated in USD expanded by 32.2% yoy. Both corporate and household sector made their contribution to growth but corporate deposits expanded faster, especially foreign currency deposits denominated in USD (75.3% yoy against 15.7% yoy for the corresponding household deposits).

In contrast, banking lending activities saw little progress in January. National currency loans remained flat, as an 8.1% yoy decline in corporate loans fully offset the 25.1% yoy growth of household loans. Foreign currency loans denominated in USD dropped 9.7% yoy which was not much less than in previous month. The decline was the result of curtailing in both corporate and especially household loans (7.1% yoy and 27.8% yoy respectively).

The monetary base curtailed by 1.6% mom in January. However, its year-over-year growth saw little changes at 9.5%. At the same time, money supply expanded at decelerated rate of 1.9% mom in the reporting month. Year-over-year, money supply grew by 16.5%.

Hryvnia Exchange Rate. The UAH/USD exchange rate was relatively stable for the most part of February. This relative stability of the exchange rate continued over the first week of March. However, after the so-called “Black Monday” on March 9th, when world stock markets collapsed on the news of coronavirus spread, the UAH/USD exchange rate started to depreciate at a fast pace. It has been depreciating for 9 trading sessions in a row. The NBU tried to slow the pace of depreciation though dollar interventions. The regulator spent USD 2.07 billion from the country’s international reserves in two weeks. The depreciation at the interbank forex market stopped on March 20th because of critically low banking system liquidity. However, the exchange rate is expected to return to depreciation as the government further reinforced the quarantine measures in the country. Overall, the exchange rate depreciated by 9.6% from February 1st to March 20th to 27.75 UAH/USD.

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



Source: The NBU, The Bleyzer Foundation

International Trade and Capital

In January 2020, Ukraine's current account had a surplus of USD 590 million. The major source of the current account surplus was a reduction in the net foreign trade deficit to an almost balanced result of USD 6 million. These improvements resulted from a higher merchandised export growth (2.3% yoy) coupled with an imports decline (-1.7% yoy), comparing to the same month of previous year. In addition, significant help was provided by increases of employees’ compensation, which amounted to USD 1,055 million in January 2020.

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Ukrainian merchandise exports amounted USD 3,811 million. Goods exports showed expansion in the following sectors: machinery and equipment (33.9% yoy), chemical products (24.9% yoy), mineral products (18.1% yoy), agricultural goods (14.3% yoy) and industrial products (9.4% yoy) respectively. Other sectors of exported goods deteriorated, including ferrous and nonferrous metals (-26.4% yoy), informal trade (-9.2% yoy) and timber and wood goods (-8% yoy) in January 2020.

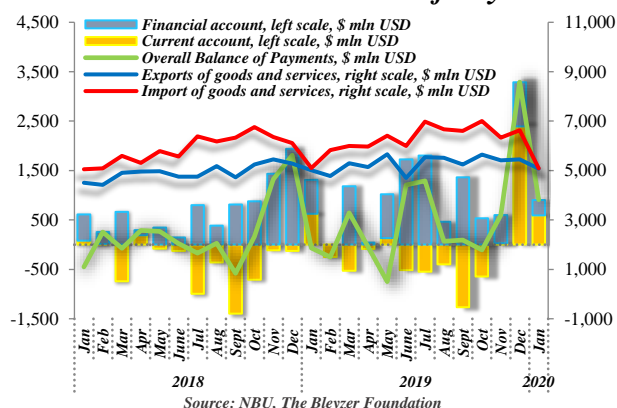
Ukrainian merchandise imports reached USD 3,942 million. Higher imports of goods took place in industrial goods (48.5% yoy) and agricultural products (16.1% yoy). Import declines took place in mineral products (-19% yoy), timber and wood goods (-8.4% yoy), ferrous and nonferrous metals (-6.3% yoy), chemicals goods (-3.2% yoy), and machinery and equipment (-0.3% yoy),

In January 2020, Ukrainian merchandise foreign trade deficit declined by 54.2% yoy to USD 131 million. During this period, Ukraine deficit trade with CIS countries was reduced by 38.2% yoy to USD 357 million from USD 1,171 million. The deficit in trade with the Russian Federation fell down by 40.6% yoy to USD 254 million from USD 534 million. At the same time, Ukrainian surplus in its foreign trade with other countries increased to USD 226 million in January 2020.

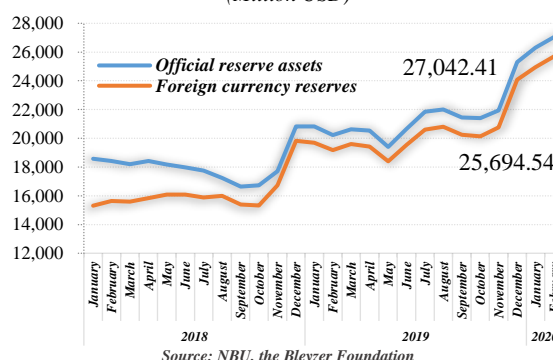
In January 2020, the highest growth in merchandise exports of Ukraine was with Australia (327.9% yoy), Asia (26.5% yoy), and Africa (2% yoy). On the other hand, reductions in goods export occurred with the EU countries (-10.4% yoy), USA (-41.5% yoy) and the Russian Federation (-12.7% yoy). At the same time, imports of products to Ukraine from CIS countries were reduced by 21.6% yoy, whereas from the United States they increased by 23.5% yoy

In January 2020, Ukrainian financial accounts inflows amounted to USD 315 million, compared to outflow of USD 687 million of January 2019. The major sources of financial account inflows were net foreign direct investments (FDI) with a growth rate of 36.7% yoy to USD 201 million. As the result, the overall consolidated balance of payments had a surplus of USD 905 million in January 2020. Therefore, foreign currency reserves increased to USD 25,694.54 million, amount of which sufficient to finance 5.1 months of imports.

Ukraine's External Balance of Payments



International Reserves of Ukraine (Million USD)



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