November 2019

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## Executive Summary


- During the past month, the Parliament introduced legislation to intensify the fight against corruption. It included increasing the role of the High Anticorruption Court (HAC) and developing the capacity of the State Investigation Bureau (SIB). The SIB has already initiated several criminal investigations against high-level government officials. The Parliament also passed in its first reading a bill "On Farmland Turnover" that foresees the lifting of the moratorium on farmland sales from October 1, 2020.
- President Zelenskyy's office announced that the leaders of France, Germany, Russia and Ukraine would meet in Paris on December 9 to intensify the efforts to search for a peaceful settlement of the Donbas Conflict.
- In the third quarter of 2019, the Ukrainian economy continued to expand, with a GDP growth rate of 4.2% yoy. GDP growth was supported by high growth in construction and retail trade. More frequent monthly output data show that economy recovery is still ongoing. For the year as a whole, GDP is expected to grow at 3.5%.
- Despite a fiscal budget deficit in September, the cumulative consolidated budget balance from the beginning of the year remained positive at UAH 8.7 billion over first nine months of the year.
- Consumer inflation continued to decelerate in September, with the overall inflation index dropping 1.3 percentage points to 7.5% yoy. The deceleration in price growth was the result of tight monetary policy and increased supply of foodstuffs thanks to a large new harvest.
- In the banking sector, Hryvnia deposits grew at a rate of 12.2% yoy, while growth of foreign currency deposits denominated in USD remained almost unchanged at 10.4% yoy. However, bank lending activities was sluggish in September, with Hryvnia loans increasing only by 0.3% yoy and foreign currency loans declining.
- In October, the UAH/USD exchange rate depreciated by 0.8% mom, fueled by reduced supplies of dollars caused by the provision of several tranches of VAT reimbursements to exporters.
- In September 2019, the deficit of Ukraine's current account of the balance of payments declined by 20.5% yoy to USD 1,111 million (compared to a deficit of USD 1,397 million in September 2018). The deficit was fully covered by USD 1,172 million of financial inflows (principally from trade credits). The overall balance of payments had a surplus of USD 60 million, increasing international reserves to USD 21.4 billion at the end of September 2019.


| *Main Macroeconomic Indicators* | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019f |
|---|---|---|---|---|---|---|---|
| ***GDP***, *USD billion* | 180 | 130 | 87 | 93.4 | 113 | 131 | 146 |
| ***Real GDP Growth***, *% yoy* | 0.0 | -6.6 | -9.9 | 2.4 | 2.5 | 3.3 | 3.5 |
| ***Fiscal Balance*** *(incl. Naftogaz/Pension Fund),% of GDP* | -6.5 | -11.7 | -2.1 | -2.3 | -1.4 | -1.9 | -2.1 |
| ***Public Debt, External and Domestic,*** *% of GDP* | 40.4 | 69.4 | 79.1 | 80.9 | 71.8 | 60.9 | 59.0 |
| ***Consumer Inflation,*** *eop, % yoy* | 0.5 | 24.9 | 43.3 | 12.4 | 13.7 | 9.8 | 8.0 |
| ***NBU Key Policy Interest Rate,*** *% eop* | 6.5 | 14.0 | 22.0 | 14.0 | 14.5 | 18.0 | 16.0 |
| ***Hryvnia Exchange Rate per USD***, *eop* | 8.2 | 15.8 | 24.0 | 27.1 | 28.1 | 27.7 | 26.0 |
| ***Current Account Balance***, *% of GDP* | -9.2 | -3.5 | 1.8 | -1.5 | -2.2 | -3.3 | -3.4 |
| ***Merchandise Exports,*** *USD billons* | 59 | 51 | 35 | 34 | 40 | 43 | 45 |
| ***Merchandise Imports,*** *USD billions* | 81 | 58 | 39 | 40 | 49 | 56 | 58 |
| ***FDI,*** *Net Annual Inflow, USD billion* | 4.5 | 0.4 | 3.0 | 3.3 | 2.3 | 2.4 | 2.0 |
| ***International Reserves***, *USD billion* | 20.4 | 7.5 | 13.3 | 15.5 | 18.8 | 20.8 | 20.0 |
| ***Public External Debt,*** *USD billion* | 31.7 | 34.9 | 42.6 | 42.5 | 47.0 | 49.9 | 50.0 |
| ***Private External Debt,*** *USD billion* | 110.3 | 91.2 | 76.0 | 69.9 | 70.0 | 71.0 | 72.0 |



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## *Political and Reform Developments*

During the October International Mariupol Investment Conference, both President Zelenskyy and Prime Minister Honcharuk confirmed their intention to accelerate reforms in the country and make it investment friendly. They stated that the main targets for reforms are (i) the current low level of property rights protection, (ii) an unfair judicial system and (iii) high levels of corruption. Several institutional investors have announced their plans to expand their presence in Ukraine, including EBRD, which is expected to reach an investment position of USD 1.2 billion by the end of this year.

During the past month, the Parliament introduced legislation to intensify the fight against corruption. It includes increasing the role of High Anticorruption Court (HAC) and developing the capacity of the State Investigation Bureau (SIB). The SIB has already initiated several criminal investigations against high-level government officials. Some cases were sent to HAC.

The Parliament also passed in its first reading a bill "On Farmland Turnover" that foresees the lifting of the moratorium on land sales from October 1, 2020. As of that date, Ukrainian citizens and legal entities of Ukraine, territorial communities, and the state can buy farmland. However, the purchase of farmland by companies in which the ultimate beneficiary is a foreigner, foreign states, citizens with no citizenship is banned until January 1, 2024. As an exception, agricultural companies operating on Ukrainian for over three years would be able to buy farmland, which they lease as of the date of the opening of the market on October 1, 2020. On the other hand, the bill proposes to deprive individuals and legal entities, and foreign states that are subject to the sanctions law, of the right to purchase land. However, changes are expected at the second reading of the bill as President Zelenskyy plans to submit to a national referendum the proposal that foreigners may purchase farmland. The total area of farmland owned by a citizen or a legal entity of Ukraine will be limited within one united territorial community not to exceed 35% of farmland of such a community, within one region – 8% of farmland of such an area and 0.5% of farmland of Ukraine (200,000 Ha), according to the bill.

The government is planning to continue its cooperation with the IMF. The proposed extended fund facility program would be designed for the term of 3 years and with a value of USD $5 billion. The new IMF program should serve as an anchor for the future structural reforms in the country. The National Bank of Ukraine said that there is a high probability that the new program would be signed by the end of 2019. An IMF mission is currently in Kyiv. A potential problem, however, is disagreement about the future of the nationalized Privatbank.

President Zelenskyy has signed a bill on unbundling of activities on transportation of natural gas into law. The law provides the necessary conditions for meeting Ukraine's obligations to unbundle gas transportation activities and ensure that the activities of the gas transmission system operator are in accordance with European law.

President Zelenskyy's office announced that the leaders of France, Germany, Russia and Ukraine would meet in Paris on December 9 to intensify the efforts for the search of a peaceful settlement of the Donbas Conflict. Prior to this high level meeting both Ukraine military forces and militants of quasi-republics started withdrawal of weapons along the line of conflict.

## *Economic Growth*

The Ukrainian economy continued to expand in Q3 despite some deceleration as compared to the previous quarter. The NBU estimated real GDP grew at 4.2% yoy in Q3, which is below the growth of 4.6% yoy in Q2 but still above expectations. GDP growth was supported by rapid expansions of construction activities and retail trade. For the year as a whole, GDP is now expected to grow by 3.5%.

Monthly data released by the State Statistics Service shows that the economy continued its improvements during September, with agricultural output increasing by 9% yoy, construction output by 12.2% yoy, and retail trade turnover by 9% yoy. Cargo transport raised by 1.8% yoy and passenger transportation by 3.2% yoy. These

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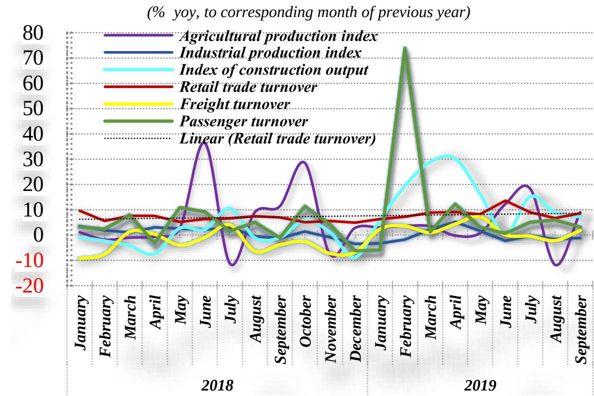
positive expansions were supported by a growth in real wages of 18.2% yoy in September. On the other hand, Ukrainian industrial output continued to slowdown, with an output reduction of 1.1% yoy in September.

Within industry, manufacturing production fell by 1.2% yoy and mining and quarrying dropped by 1.2% yoy. The slowdown in September was caused by significant reductions of a textile manufacturing output, sewing of clothes, leather, leather articles (-10.3% yoy), followed by declines in basic metals and fabricated metal products (-5.4% yoy), wood products, paper and printing (-5.2% yoy); rubber and plastic products (-4.7% yoy); machinery and equipment (-3.6% yoy); and coke and refined petroleum products (-3.4% yoy).

**Ukraine Economic Performance by Sector**

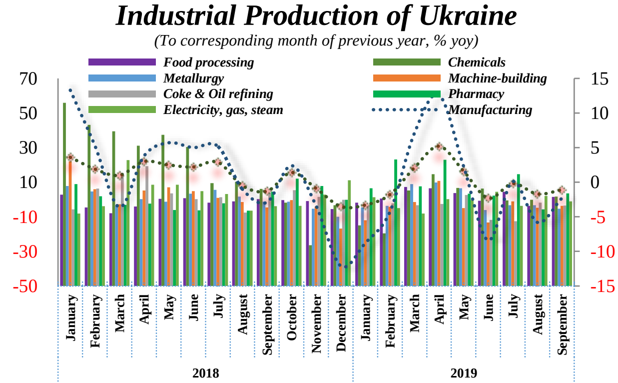



Source: The Bleyzer Foundation

On the other hand, positive growth rates were driven by significant increases of furniture and other repair, and installation of machinery and equipment (10.9%yoy), as well as basic pharmaceutical products (3.5% yoy). Moreover, chemicals and chemical products grew by 1.7% yoy, while foodstuffs, beverages and tobacco products raised by 1.6% yoy, in September 2019.

With regard to the geographical distribution of industrial production, the largest output increases in September took place in Odesa (18.1% yoy), Kirovohrad (12.6% yoy), Donetsk (9.2% yoy), Ternopil (9% yoy), Kherson (8.2% yoy), Vinnytsya (7.5% yoy), Lviv (3.4% yoy), Volyn (2.3% yoy), and Kyiv city (0.7% yoy), correspondingly.

**Industrial Production of Ukraine**




Source: The Bleyzer Foundation

On the other side, the highest declines in production occurred in Zakarpattya (-30.7% yoy), Luhansk (-14% yoy), Khmelnytskiy (-13% yoy), Rivne (-11.4% yoy), Chernihiv (-10.4%yoy), Ivano-Frankivsk (-10.1% yoy), Poltava (-5.2% yoy), Zaporizhzhya (-4.9% yoy), Mikolayiv (-4.4% yoy), Sumy (-3.8% yoy), Dnipropetrovsk (-3.6% yoy), Chernivtsi (-3.5% yoy), Cherkasy (-3.4% yoy), Zhytomyr (-2.9% yoy), Kharkiv (-2.3% yoy) and Kyiv (-1.7% yoy).

## *Fiscal Policy*

The consolidated fiscal budget balance turned negative in September. The total fiscal deficit of UAH 26.7 billion was the result of negative balances at both central and local levels (UAH 23.1 billion and UAH 3.6 billion respectively). Although the government made significant borrowing in the course of budget execution in September, it also made significant repayments of previous borrowings. As a result, net borrowing were relatively low at UAH 1.7 billion. The rest of the deficit of UAH 25 billion was financed through active operations (mainly changes in cash resources). Cumulative consolidated budget balance from the beginning of the year remained positive at UAH 8.7 billion over first nine months of the year.

On the revenue side, consolidated budget revenues returned to growth in September. They expanded by 3.7%

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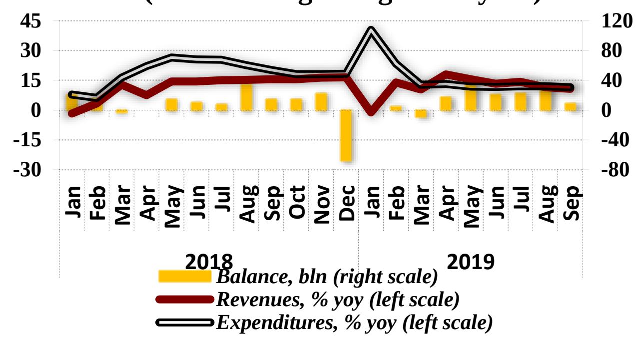
yoy thanks to higher receipts at the local level. Growth was driven by tax revenues which grew by 5.3% yoy. Non-tax revenues dropped by 7.7% yoy because of signifiant decline in transfers of profits from the state-owned companies. Growth of tax revenues themselves was limited by slower growth of imports and purchases of the natural gas using the "customs storage" mode. As a result, the VAT on imported goods saw a 10.4% yoy decline in receipts. Excise taxes on imported goods grew at a good but decelerated rate of 8.7% yoy. Taking into account the relatively small amount of VAT reimbursements to exporters in September, reciepts from VAT on domestic goods posted a significantly accelerated growth of 85.1% yoy. Reciepts from personal income tax continued to grow at fast pace (18.8% yoy), while those from corporate profit taxes significantly dropped (by 40.0% yoy) because of statistical base effect and the effect of temporary factors. Growth of cumulative consolidated budget revenues from the beginning of the year further slowed down to 10.8% yoy in January-September.

***Dynamics of consolidated budget components (from the beginning of the year)***




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

On the expenditures side, growth of consolidated budget expenditures decelerated again in September. The growth rate dropped to 8.5% yoy because of slower expansion at the central level. Current expenditures grew by 8.6% yoy, while capital expenditures increased by 7.6% yoy. Deceleration in growth of current expenditures was the result of a decline in debt servicing expenditures (by 1.2% yoy) and signficant deceleration in growth of current transfers (to 15.2% yoy). Growth of payroll expenditures and expenditures on goods and services remained almost unchanged at 20.6% yoy and 3.9% yoy respectively. At the same time, social secutity expenditures grew at accelerated pace (by 11.0% yoy). Growth of cumulative consolidated budget expenditures from the beginning of the year slightly decelerated to 11.6% yoy in January-September.

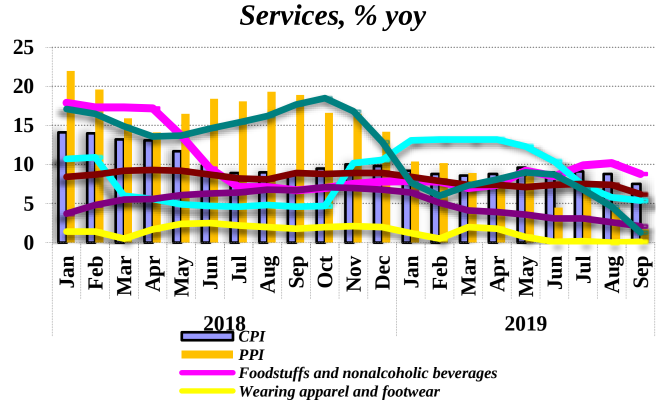
The government and the NBU made payments on state and guaranteed debt denominated in foreign currency totaling USD 1,973.8 million equivalent, which is 7.5 times more than a month ago. The largest share was spent on principal and servicing payments on Eurobonds (USD 1,223.7 million). USD 560.9 million was paid to the IMF. The rest was paid on other liabilities to foreign creditors and IFIs. At the same time, total foreign currency payments on state and guaranteed debt were partially compensated for by inflows from the placement of domestic sovereign bonds denominated in foreign currency totaling USD 546.9 million.

## *Monetary Policy*

**Inflation.** Consumer inflation decelerated again in September. The all items index dropped 1.3 percentage points to 7.5% yoy. The deceleration in price growth was the result of strict monetary policy through the exchange rate channel and increased supply of whole foodstuffs thanks to a new harvest. Core inflation slowed by 0.7 percentage points to 6.5% yoy.

Several of the major groups of goods and services observed significant slowdowns in their price growth. The most significant deceleration of price growth was registered for transport

***CPI, PPI, and Growth of Prices for Select Goods and Services, % yoy***

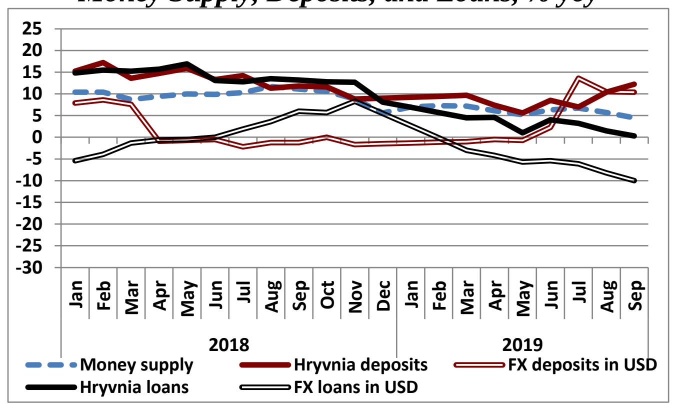



*Source: State Statistical Service of Ukraine, The Bleyzer Foundation* services (3.3 percentage points to 1.3% yoy). Growth of communication services prices slowed by 2.5 percentage points to 14.5% yoy. Foodstuffs, healthcare, and culture and recreation saw growth of their price decelerating by slightly more than 1 percentage point to 8.8% yoy, 6.2% yoy, and 1.4% yoy respectively. Changes in price growth of other groups of goods and services were below 0.5 percentage points.

We leave our forecast of consumer inflation unchanged at 8.0% yoy at the end of the year.

**Banking Sector.** Banking deposits sustained further improvements in September. National currency deposits grew at an expanded rate of 12.2% yoy, while growth of foreign currency deposits denominated in USD remained almost unchanged at 10.4% yoy. National currency deposits expanded on the back of both corporate and household sectors. Corporate deposits saw their growth rate almost doubled to 15.0% yoy, while household deposits grew a bit slower than in August but at decent level of 12.3% yoy. Foreign currency deposits denominated in USD followed the same trends observed in August. Household deposits expanded at slightly accelerated pace (6.8% yoy) compensating for slower growth of the corporate deposits (19.8% yoy).

***Money Supply, Deposits, and Loans, % yoy***



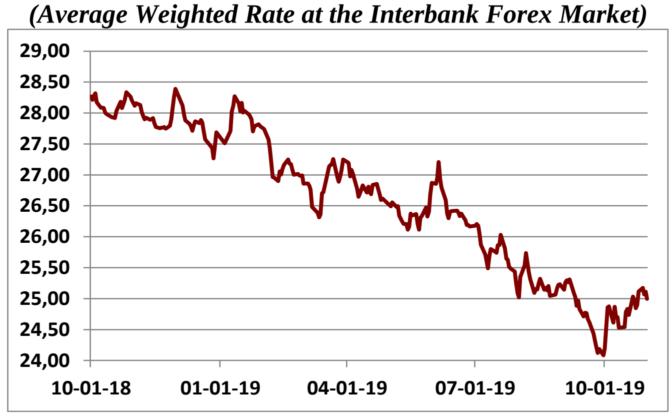

*Source: The NBU, The Bleyzer Foundation*

Bank lending saw mostly negative developments in September. National currency loans inched up by 0.3% yoy, which is 5 times slower than a month ago. Household loans expanded by 25.6% yoy on the back of consumer loan boom. At the same time, corporate loans dropped 6.7% yoy. The decline of foreign currency loans denominated in USD further accelerated reaching 10.0% yoy. This happened because of accelerated declines in both corporate and household sectors (7.6% yoy and 24.4% yoy respectively).

Both monetary base and money supply grew at slower pace in September. Monetary base decreased by 1.1% mom which led to its over-year growth deceleration to 3.9% yoy. Money supply remained almost unchanged in monthly terms but its over-year growth decelerated to 4.5% yoy.

**Hryvnia Exchange Rate.** The UAH/USD exchange rate was quite volatile in October. However, it is possible to derive several major trends in its dynamics. After a short period of depreciation, which started at the end of September due to unsatisfactory results of negotiations with the IMF and lower supply of dollar on the side of non-residents, the exchange rate gradually appreciated until October 11th. Then, prolonged weekend led to accumulation of deferred demand for dollar causing the exchange rate trend reversal. Depreciation of dollar lasted until October 29th being fueled by several tranches of the VAT reimbursements to exporters on the side of the Treasury, which caused temporary declines in dollar supply at the market. On October 29th, the exchange rate trend reversed again, as some players had to

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

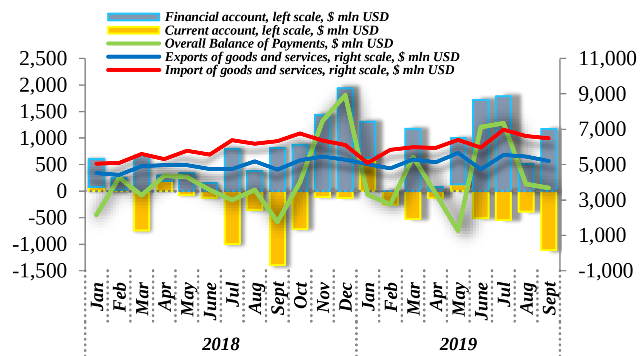



*Source: The NBU, The Bleyzer Foundation* finalize their tax payments, while hryvnia resources were relatively low. Thus, those businesses had to sell extra amounts of dollar at the interbank forex market. Overall, the exchange rate depreciated by 0.8% mom in October.

## *International Trade and Capital*

In September 2019, the deficit of Ukraine's current account of the balance of payments declined by 20.5% yoy to USD 1,111 million (compared to a deficit of USD 1,397 million in September 2018). This monthly deficit also decreased the cumulative current account deficit for January-September by 20.7% yoy to USD 2,705 million (or 2.5% of GDP).

***Ukraine's External Balance of Payments***




*Source: NBU, the Bleyzer Foundation*

The major cause of the current account deficit reduction was a higher rate of growth of merchandise exports (by 11.9% yoy to USD 3,712 million), than the increase of merchandise imports (2% yoy to USD 5,133 million.) Therefore, the total merchandised trade net deficit fell down by 17.1% yoy to USD 1,421 million, which led to a reduction in the net deficit of total goods and services by 20% yoy, to USD 1,288 million, in September 2019.

Regarding Ukraine's merchandise export distribution by sectors, the best export performance took place in the following sectors: machinery and equipment (31.4% yoy), agricultural products (29.4% yoy), minerals goods (15.2% yoy), informal trade (11.2% yoy), chemical products (2.7% yoy) and industrial goods (1.9% yoy). On the other hand, negative growth took place in timber (wood) and metal good's exports, which had -10.8% yoy and -16% yoy, correspondingly.

Ukraine's merchandised import showed major growth in the industrial sector (25.4% yoy), followed by agricultural products (19.2% yoy), machinery and equipment goods (16.2% yoy), ferrous and nonferrous metals (7.3% yoy) and chemical products (5% yoy). At the same time, Ukraine's goods import declined in two sectors related to mineral and wood products, which dropped by 19.2% yoy and 1.4% yoy, correspondingly.

The September current account deficit was fully covered by net financial account inflows of USD 1,172 million, compared to USD 810 million in September 2018. The main growth of the financial account inflows took place in private sector inflows (USD 1,289 million, including error and omissions). A major component was external trade credits, which grew to USD 694 million (USD 299 million on September 2018). Ukrainian Foreign Direct Investment (FDI) had net inflows amounting to USD 255 million, compared to the USD 104 million, in September 2018.

***International Reserve of Ukraine, million USD***


*Source: NBU, the Bleyzer Foundation*

Finally, thanks to the surplus of the financial account, the over surplus in the balance of payments reached USD 60 million. Therefore, the level of international reserves increased to USD 21.4 billion, sufficient to maintain 3.4 months of future imports, as of September 2019.