

June 2017

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Executive Summary

- ❖ Russian-backed separatists in Eastern Ukraine are continuing their attacks against Ukrainian militants and civilians. The minimum number of daily attacks from the site of separatists is still high, at a level of 10. Moreover, the number of victims from the civilian population have increased significantly. In recent international gatherings, Russia has been under pressure to stop its support of separatists and ensure a ceasefire.
- ❖ The main reform efforts of the government are concentrated on fighting corruption and reforming the country's health care and pension systems. Progress is being made in these areas, but a major pending issue is the lack of independent anti-corruption courts that could ensure the impartial prosecution of corrupt officials.
- ❖ The State Statistics Committee has reported that Ukraine's GDP grew by 2.5% yoy in the first quarter of 2017. The highest rates of growth took place in construction activities (with 21.3% yoy increase), real estate activities (6.2% yoy increase), transportation and storage (4.7% yoy), information and communications (4.3% yoy), accommodation and food service activities (3.5% yoy), manufacturing (3.2% yoy), and wholesale and retail trade (which grew by 3% yoy).
- ❖ More frequent monthly output data shows that the economy is continuing to recover. In May 2017 Ukraine's construction sector expanded by 25% yoy. Similar recover took place in the retail trade turnover which increased by 10.7% yoy. Furthermore, industrial production grew by 1.2% yoy in May, despite hostilities and a trade blockade in the East. However, in May 2017, Ukraine agricultural production continued to decline with a -3% yoy drop.
- ❖ In May 2017, the state budget was executed with a surplus for the second month in a row thanks to fast increases in revenues. Local budgets were also executed with surpluses which were comparable to those in April, at UAH 4.5 billion. Thus the cumulative balance of the consolidated budget from the beginning of the year to May remained positive and even further expanded to UAH 50.5 billion.
- ❖ Consumer inflation accelerated in May to 13.5% yoy because of higher growth in prices of foodstuffs and further increases in administered tariffs and prices. But core inflation remained almost flat at 6.5% yoy. For the entire year, inflation is still expected to be around 10%.
- ❖ The UAH/USD exchange rate appreciated in May, thanks to inflows of foreign currency from exporters and private sector financing. At the same time, the National Bank continued its purchase of dollars on the interbank forex market to replenish the international reserves softening appreciation pressures. As a result, the exchange rate appreciated only to UAH/USD 26.02 by the end of the month.
- ❖ In May 2017, Ukraine's current account deficit amounted to USD 194 million, compared to USD 293 million in May 2016. This current account deficit was fully covered by net inflows in the financial account, which amounted to USD 556 million in May. These funds increased international reserves to USD 17.6 billion by early June.

Main Macroeconomic Indicators	2011	2012	2013	2014	2015	2016	2017f
GDP, USD billion	163	173	180	130	87	93.4	97.2
Real GDP Growth, % yoy	5.5	0.2	0.0	-6.6	-9.9	2.3	2.5
Fiscal Balance (incl. Naftogaz/Pension Fund), % of GDP	-4.3	-5.5	-6.5	-11.7	-2.1	-2.3	-3.5
Public Debt, External and Domestic, % of GDP	36.4	36.6	40.4	69.4	79.1	81.2	82.0
Consumer Inflation, eop, % yoy	4.6	-0.2	0.5	24.9	43.3	12.4	10.0
Hryvnia Exchange Rate per USD, eop	8.0	8.1	8.2	15.8	24.0	27.0	28.0
Current Account Balance, % of GDP	-6.3	-8.3	-9.0	-4.1	-0.2	-4.1	-3.5
FDI, Net Annual Inflow, USD billion	7.0	7.2	4.1	0.3	2.3	3.4	3.0
International Reserves, USD billion	31.8	24.5	20.4	7.5	13.3	15.5	16.0
Public External Debt, USD billion	33.3	32.1	31.7	34.9	42.6	42.5	47.0
Private External Debt, USD billion	92.7	102.3	110.3	91.2	76.0	69.9	65.0

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Political and Reform Developments

Russian-backed separatists in Eastern Ukraine are continuing their attacks against Ukrainian militants and civilians, despite the recent agreement under the “bread armistice”. The initial agreement on ceasefire was expected to continue until the end of the harvest season in Ukraine. However, the minimum number of daily attacks from the site of separatists is still high at a level of 10. Moreover, number of victims from civilian population have increased significantly.

All major international gatherings, including G-20 and bilateral meetings, have in their agendas the situation in Ukraine. Possible peaceful solutions for the war in Ukraine were discussed during the most recent meetings of President Poroshenko with US President Trump, French President Macron, Chancellor Merkel, and others. The leaders of these meetings clearly stated that the military conflict in Ukraine should be re-solved as soon as possible. The next round of a high level Normandy format meeting is expected in July.

Ukraine continues to implement its reform agenda. Its main efforts were concentrated in fighting corruption and reforming the country’s health care and pension system. During the month, the office of Anti-corruption Prosecutor and National Agency for Fighting Corruption prepared several cases against Ukrainian top government officials. The list includes five members of Parliament. The correspondent materials have been submitted to Verhovna Rada. But the submission of these criminal cases to Court is fully dependent on a decision of Parliament to withdraw the immunity of these MPs. It is expected that under the pressure of both international partners of Ukraine and civil society this decision will be taken shortly. As it was reported by the General Prosecutor Office, several cases against number of other lower level government officials were already submitted to courts. However the significant obstacle to move forward is the absence of independent anticorruption courts. Creating these specific courts is a part of the agreement of Ukraine with a number of international institutions. But so far, there has been little progress.

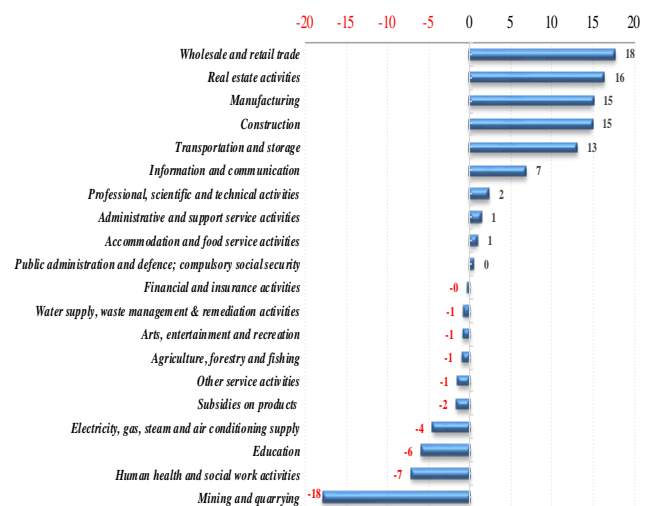
The acting Minister of Health Ulyana Suprun and her team continue to implement overdue reforms in this sector. The first results are encouraging. The Ministry was able to save tens of millions dollars of Ukrainian taxpayers by transferring procurement of pharmaceutical products to international institutions acting on an “outsourcing approach”, which eliminates corruption in public procurement in the health care sector.

The concept for reforming the Ukrainian current “pay-as-you-go” pension system was presented by the Cabinet of Ministers to the general public. The main efforts will be concentrated in eliminating the deficit of the pension system fund. This may be reached through increases in effective pension age and eliminating privileges and distortions in this sector.

Economic Growth

The State Statistics Committee has reported that Ukraine’s GDP grew by 2.5% yoy in the first quarter of 2017. The highest rates of growth took place in construction activities (with 21.3% yoy increase), real estate activities (6.2% yoy increase), transportation and storage (4.7% yoy), information and communications (4.3% yoy), accommodation and food service activities (3.5% yoy), manufacturing (3.2% yoy), and wholesale and retail trade (which grew by 3% yoy).

GDP production side contribution of Q1 2017
(In % of the total GDP growth amount)



Source: The Bleyzer Foundation

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On the other hand, the weakest performance in GDP growth during the first quarter took place in the mining & quarrying sector with a -7.5% yoy fall. This poor performance was due to increased hostilities in the East and the trade embargo there. Health & social work activities also decreased by -6.8% yoy. Water supply and waste management activities fell by -4.5% yoy. Agriculture, forestry with fishing declined by -0.7% yoy due to bad weather.

Regarding to the contribution of individual sectors to GDP growth, six relatively large sectors generated more than half of the total contribution to GDP growth in the 1st quarter of 2017, as following: Ukraine wholesale and retail trade (17.6% contribution to the 2.5% GDP growth), manufacturing (15% contribution) transportation & storage (13% contribution), real estate activities (16.4%) and construction (14.8%).

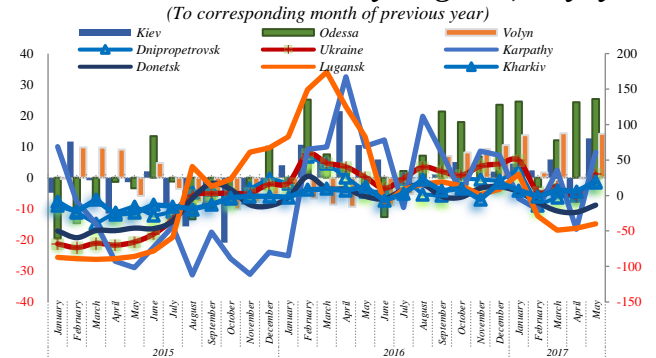
On the expenditure side of GDP, the largest contributions to GDP growth were household's consumption, with 1.8% contribution (and an increase of 2.5% yoy), general government expenditures with 0.6% contribution, and gross capital formation with a 0.4% contribution (growth of 12% yoy). But, these gains were partly offset by a negative trade balance of Ukraine, with imports increasing by 2.9% yoy in the first quarter of 2017, due principally to energy imports.

More frequent monthly output data shows that the economy is continuing to recover. In May 2017, Ukraine's construction sector expanded by 25% yoy. Similar recover took place in the retail trade turnover which increased by 10.7% yoy. Furthermore, industrial production grew by 1.2% yoy, despite the hostilities and trade blockade in the East. However, in May 2017, Ukraine agricultural production continued to decline with a -3% yoy drop.

In May 2017, within the industrial sector, the following activities had the highest rates of growth: pharmaceutical products (23.7% yoy), computer and optical products (18.3% yoy), engineering (14.7% yoy), textiles (14.4% yoy), wood products (10.7% yoy), rubber/ plastic products (8.5% yoy), and foodstuffs (7.7% yoy). The lowest rates of growth took place in coke and refined petroleum products (-21% yoy), electricity, gas, steam and air conditioning supply (-9.6% yoy), metals (-8.0% yoy), mining and quarrying (-4.6% yoy), and chemicals with agricultural products (-1.1% yoy).

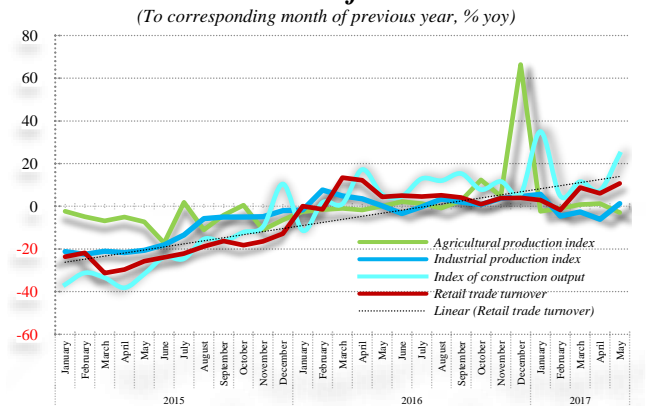
Regarding regional distribution of industrial output, in May 2017, the most positive growth took place in Rivne (41.9% yoy), Odessa (25.4% yoy), Chernivtsi (20.0% yoy), Ternopil (19.2% yoy), Kharkiv (19.1% yoy), Zaporizhzhya (14.4% yoy), Kherson (14.4% yoy), Volyn (14.1% yoy), Kiev (12.7% yoy), Ivano-Frankivsk (12.3% yoy), Kirovograd (10% yoy), Lviv (9.5% yoy), Zakarpattya (8.3% yoy), Zhytomyr (4.5% yoy), m. Kyiv (3.2% yoy), Sums (2.2% yoy), and Kmelnytsky (1.3% yoy), in May 2017. Other regions had declines in industrial output, due to the hostilities and trade blockade: Lugansk, (-40.0% yoy), Donetsk (-13.5% yoy), Poltava (-5.9% yoy), Mikolaiv (-2.9% yoy), Dnipropetrovsk (-1.5% yoy), Vinnytsya (-1.1% yoy), Chernihiv (-0.5% yoy).

Industrial Production by Regions, % yoy



Source: The Bleyzer Foundation

Real Sector of Ukraine



Source: The Bleyzer Foundation

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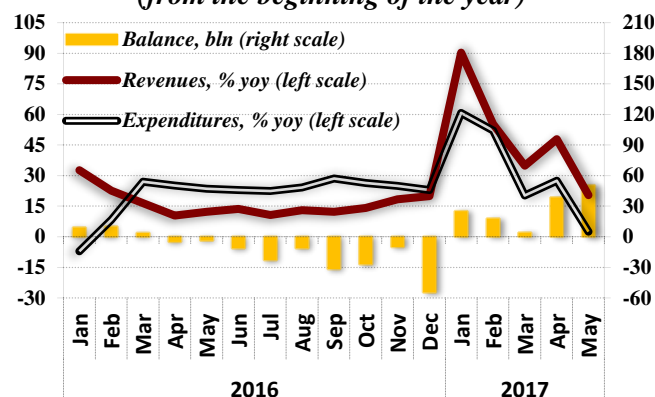
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Fiscal Policy

In May 2017, the state budget was executed with a surplus for the second month in a row thanks to fast increases in revenues. At the same time, the surplus at UAH 7.0 billion was significantly lower than in April. Local budgets were also executed with surpluses which were comparable to those in April at UAH 4.5 billion. Thus the cumulative balance of the consolidated budget from the beginning of the year remained positive and even further expanded to UAH 50.5 billion.

State budget revenues continued to grow at fast pace in May. Their 39.6% yoy growth was due to increased tax revenues, the growth rate of which accelerated to 32.7% yoy thanks to 1.9 times higher receipts from corporate profit taxes. Growth of VAT receipts accelerated on the back of increased imports, particularly natural gas imports. At the same time, VAT reimbursements remained high at UAH 9.9 billion (a 48% yoy increase). Receipts from personal income tax, royalties, and taxes on international trade also grew at high pace (31.7% yoy, 10.5% yoy, and 32.8% yoy respectively). On the other hand, growth of receipts from the excise taxes somewhat decelerated (to 6.6% yoy for excise taxes on domestic goods and to 23.7% yoy for excise taxes on imported goods). Transfer of a share of the NBU's profits of 2016 to the state budget was a major factor of high growth (84.0% yoy) of non-tax revenues in May. Growth of budget revenues at the local level remained high in May despite some deceleration in growth of local budget own revenues. Despite fast growth of both state and local budgets revenues in May, the increase of the cumulative consolidated budget revenues from the beginning of the year significantly decelerated (more than halved to 20.4% yoy).

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



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

Growth of the state budget expenditures expanded in May but remained significantly lower than that of revenues. The 15.1% yoy growth was caused by higher current transfers and payroll expenditures. Furthermore, growth of expenditures on goods and services accelerated, same as expenditures on domestic debt servicing. At the same time, social security expenditures remained below the previous year level because of lower transfers to the Pension Fund, which were the result of higher receipts from the single social contribution and technical delays in calculation of subsidies to households. Growth of capital expenditures also slightly decelerated. Growth of the local budget expenditures accelerated thanks to both current and capital expenditures. However, similarly to the situation with revenues, growth of the cumulative consolidated budget expenditures from the beginning of the year significantly decelerated, dropping from 27.5% yoy in January-April to 2.5% yoy in January-May.

Monetary Policy

Inflation. Consumer inflation accelerated in May by 3.3 percentage points to 13.5% yoy because of higher growth in prices of foodstuffs and another increase in administered tariffs and prices. Core inflation remained almost flat at 6.5% yoy. In particular, growth in housing and utilities tariffs accelerated by 3.5 percentage points to 28.6% yoy due to the increase in tariffs of cold water supply and sewerage. Growth of foodstuffs prices accelerated to 10.6% yoy because of faster than expected growth in prices of meat and dairy products caused by growth in world prices of these products and active exports. Some deterioration in expectations concerning future harvest also had a negative impact on food prices, specifically on prices of fruits and vegetables.

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Banking Sector. In May 2017 both national currency deposits and foreign currency deposits observed almost no changes on a month-over-month basis. However, on a year-over-year basis, national currency deposits significantly decelerated to 11.9% yoy due to further deceleration in growth of the corporate deposits (to 9.1% yoy), while growth of the household deposits saw little changes at 12.2% yoy. On the other hand, growth of the foreign currency deposits denominated in USD accelerated to 5.0% yoy on the back of return of corporate sector deposits to growth (0.6% yoy compared to 3.7% yoy decline in April). The decline in household foreign currency loans denominated in USD remained almost unchanged at 3.9% yoy.

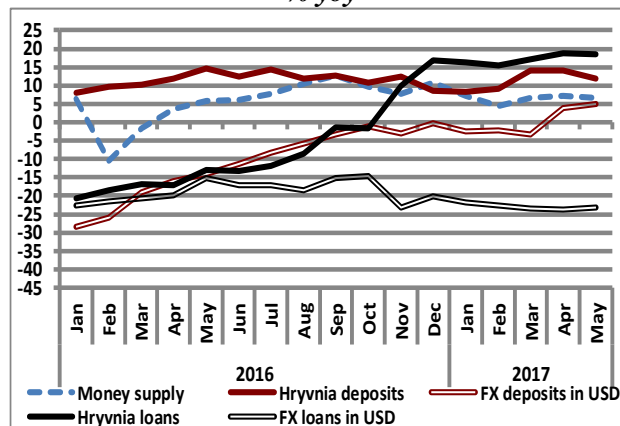
Bank lending activities continued to remain weak in May. In particular, growth of the national currency loans decelerated by 0.3 percentage points to 18.4% yoy. High growth in corporate loans (23.7% yoy) had to compensate for much slower growth in household loans (5.4% yoy). Foreign currency loans denominated in USD also saw little changes in their dynamics in year-over-year terms. The decline of those loans marginally decelerated in the corporate sector (to 24.2% yoy) but slightly accelerated in the household sector (to 19.1% yoy). Thus the overall, decline remained little changed at 23.3% yoy.

The monetary base remained flat in monthly terms as the increase in cash outside banks almost fully offset the decline in cash in banks and in balances at the correspondent accounts of banks. Therefore, the over-year growth in monetary base decelerated from 9.7% to 9.1%. Similarly, money supply also remained almost unchanged in monthly terms, while its year-over-year growth decelerated by 0.5 percentage points to 6.7%.

Hryvnia Exchange Rate. The trend of the appreciation of the UAH/USD exchange rate continued in June. As usual in the summer, business activities declined, leading to lower demand for USD on the side of importers. Thus, inflows of USD exceeded outflows. The NBU continued purchasing dollar to replenish international reserves and mitigate fluctuations at the interbank forex exchange market. As a result, the exchange rate appreciated by almost 1% to 26.023 as of June 30th, 2017.

The NBU continues with the reform of the foreign exchange market in the country. The regulator implemented the procedure of issuing e-licences on foreign exchange operations to private non-entrepreneur persons. A person with such license will be eligible to transfer abroad up to USD 50,000 a year for the purposes of investment, transferring funds to own accounts, fulfilling obligations to non-residents in relation to life insurance agreements. The regulator also simplified operations with foreign exchange assets for banks and their clients. In particular, the NBU simplified procedures for the forward foreign exchange operations. It also extended the list of operations with banking metals which can be executed by authorized banks. Finally, the NBU lifted limitations on non-cash foreign exchange operations for private persons who are not registered as entrepreneurs.

Dynamics of Money Supply, Deposits, and Loans, % yoy



Source: The NBU, The Bleyzer Foundation

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



Source: The NBU, The Bleyzer Foundation

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International Trade and Capital

In May 2017, the deficit of the current account in the balance-of-payment of Ukraine amounted to USD 194 million, bring the cumulative deficit of the current account to USD 1.1 billion (or 2.8% of GDP) for January-May 2017. This deficit compares favorably with the deficit of 3.3% of GDP in the corresponding period of the previous year.

During May 2017, Ukraine merchandise exports grew by 21.4% yoy, reaching USD 3.2 billion, compared to 8.2% yoy in April 2017 (USD 3.1 billion.) On the other hand, in May 2017 Ukraine merchandise import increased at a faster pace of 40.9% yoy to USD 3.9 billion.

During May, the largest increases in exports took place in agricultural products (30.2% yoy export increase), mineral products (29.3% yoy), industrial goods (29.3% yoy), ferrous and nonferrous metals (18.7% yoy), machinery and equipment (12.2% yoy), timber and wood products (11.0% yoy), and chemicals (4.9% yoy).

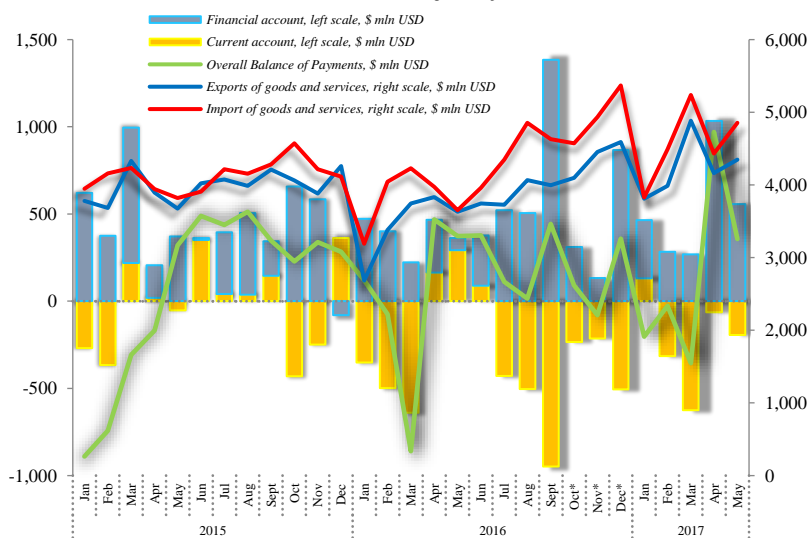
With regard to merchandised imports, the largest amounts occurred in imports of mineral products, particularly energy, with 108% yoy growth. Imports of machinery and equipment grew by 48.1% yoy, ferrous and nonferrous metals by 43.5% yoy, chemicals by 32.4% yoy, industrial goods by 22.6% yoy, agricultural products by 21.6% yoy and wood products by 19% yoy.

From the point of view of regional orientation, in January-May 2017 Ukrainian exports to Europe grew by 28.6% yoy, while imports from the EU showed higher results with 30.4% yoy. Ukraine's trade with the Russian Federation showed a similar pattern with Ukrainian exports increasing by 39% yoy while imports from Russia growing by 45% yoy.

In May 2017, Ukraine's financial accounts generated net financial inflows of USD 556 million. By contrast, in May 2016, net financial inflows amounted to only USD 69 million. Moreover, in January-May 2017, the financial account net inflows amounted USD 1.8 billion, compared to USD 1.0 billion in January-May 2016. The main source of the financial inflows of USD 556 million in May 2017 were private sector financing and trade credits. Foreign direct investments were negligible at only USD 14 million in May.

Since the financial inflows of USD 556 million were able to fully cover the current account deficit of USD 194 million in May, the level of international reserves increased during the month, reaching USD 17.6 billion by the beginning of June 2017.

Ukraine's External Balance of Payments, million USD



Source: NBU, The Bleyzer Foundation

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