

January 2018

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### *Executive Summary*

- ❖ Russian-backed separatists have intensified their military attacks against the Ukrainian army and the border territories controlled by the central government. The intensity of daily artillery shootings is high at about 10 to 20 per day. More than 400 Ukrainian civilians and militants were killed in 2017. Ukrainian international allies continue their support to the country. The most recent decision of the US to supply Ukraine with the lethal weapon equipment should increase the country's defensive capacity.
- ❖ The reform agenda in Ukraine and international support to Ukraine are hindered by slow progress in fighting corruption and in judiciary reform. The draft law on the anticorruption court - in line with the IMF, EU and Venice Commission requirements – expected to be enacted by Verhovna Rada in February/March. A privatization plan has been approved by the Parliament as a part of the general program of fighting corruption and of increasing efficiency.
- ❖ The State Statistical Service estimates that real GDP grew by 2.2% in 2017. This means that the Ukrainian economy has been growing for eight consecutive quarters. Nevertheless, the last quarter of 2017 showed a slowdown in the growth rate to 1.8% yoy. High-frequency data for December 2017, however, shows that the economic performance of Ukraine has started to improve, principally in the service and construction sectors, with retail trade turnover increasing by 16.1% yoy, construction output by 9.7% yoy, and freight and passenger turnover by 4.1 % yoy.
- ❖ The consolidated fiscal budget (state and local) for 2017 had a deficit of UAH 42.1 billion (or about 1.5% of GDP), substantially lower than the deficit agreed with the IMF and lower than the 2016 deficit of 2.3% of GDP.
- ❖ Consumer inflation in 2017 reached 13.7% yoy, exceeding the NBU upper target of 10%.
- ❖ In the banking sector, Hryvnia deposits further expanded in December, with household deposits growing by 19.4% yoy, while foreign currency deposits denominated in USD remained almost unchanged. On the banking lending side, national currency loans expanded thanks to loans to the household sector, while foreign currency loans declined.
- ❖ The UAH/USD exchange rate depreciated during the first 3 ½ weeks of January, following seasonal trends. The NBU, however, made several monetary adjustments at the end of January which led to a reversal of trend. As a result, the exchange rate appreciated back to the level observed at the beginning of the month.
- ❖ In 2017, Ukraine's current account deficit amounted to 3.7% of GDP (USD 3.8 billion), compared to 3.8% of GDP in 2016. During the year, exports of goods increased by 19% yoy to USD 39,876 million, while goods import raised by 21% yoy to USD 49,034 million. Since net financial inflows amounted to USD 6.4 billion in 2017, they allowed international reserves to increase to USD 18.8 billion by the end 2017 (3.6 month of the future imports).

| <b>Main Macroeconomic Indicators</b>                          | <b>2012</b> | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>2016</b> | <b>2017e</b> | <b>2018f</b> |
|---|-------------|-------------|-------------|-------------|-------------|--------------|--------------|
| <b>GDP, USD billion</b>                                       | 173         | 180         | 130         | 87          | 93.4        | 104          | 110          |
| <b>Real GDP Growth, % yoy</b>                                 | 0.2         | 0.0         | -6.6        | -9.9        | 2.3         | 2.2          | 3.0          |
| <b>Fiscal Balance (incl. Naftogaz/Pension Fund), % of GDP</b> | -5.5        | -6.5        | -11.7       | -2.1        | -2.3        | -1.5         | -2.5         |
| <b>Public Debt, External and Domestic, % of GDP</b>           | 36.6        | 40.4        | 69.4        | 79.1        | 81.2        | 78.5         | 78.0         |
| <b>Consumer Inflation, eop, % yoy</b>                         | -0.2        | 0.5         | 24.9        | 43.3        | 12.4        | 13.7         | 9.0          |
| <b>Hryvnia Exchange Rate per USD, eop</b>                     | 8.1         | 8.2         | 15.8        | 24.0        | 27.1        | 28.1         | 29.5         |
| <b>Current Account Balance, % of GDP</b>                      | -8.3        | -9.2        | -3.5        | -0.2        | -3.8        | -3.7         | -3.5         |
| <b>FDI, Net Annual Inflow, USD billion</b>                    | 7.2         | 4.1         | 0.3         | 2.3         | 3.4         | 3.0          | 5.0          |
| <b>International Reserves, USD billion</b>                    | 24.5        | 20.4        | 7.5         | 13.3        | 15.5        | 18.8         | 21.0         |
| <b>Public External Debt, USD billion</b>                      | 32.1        | 31.7        | 34.9        | 42.6        | 42.5        | 47.0         | 52.0         |
| <b>Private External Debt, USD billion</b>                     | 102.3       | 110.3       | 91.2        | 76.0        | 69.9        | 67.0         | 72.0         |

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### *Political and Reform Developments*

Russian-backed separatists have intensified their military attacks against the Ukrainian army and the border territories controlled by the central government. The intensity of daily artillery shootings is high at about 10 to 20 per day. Many of these attacks took the lives of ordinary Ukrainians. More than 400 Ukrainian civilians and militants were killed in 2017. The Ukrainian international allies continue their support to the country. The most recent decision of the US to supply Ukraine with the lethal weapon equipment such as Javelins should increase the country's defensive capacity. It is expected that the actual supply of weapons would start shortly. Following this supply, Canada and the EU may also supply lethal defensive weapons to Ukraine.

Conflict resolution in Ukraine continues to be an important part of the international security agenda. It was discussed during the most recent meeting of the World Economic Forum in Davos in January. It is expected that the UN peacekeepers would be introduced to the conflict territory in the Eastern part of Ukraine within the course of 2018. This was reconfirmed during the forum by world leaders and Ukrainian president Poroshenko.

In January, Prime Minister Groisman stated the government plan of ensuring a high rate of economic growth in Ukraine of 5%-7%, and declared that this would be impossible without a faster implementation of the reform agenda. One of the most important key items in the agenda is fighting corruption. There is a broad consensus among all international donors and civil society of the country that the anticorruption court should be introduced as soon as possible. Given a necessity of ensuring international support to Ukraine, the new draft law on the anticorruption court should be in line with the IMF, EU and Venice Commission requirements. Modifications to the draft law will be submitted to Verhovna Rada and voted in February/March. A privatization plan has been already prepared and approved by the Parliament as a part of the general program of fighting corruption and of increasing efficiency in the Ukrainian economy

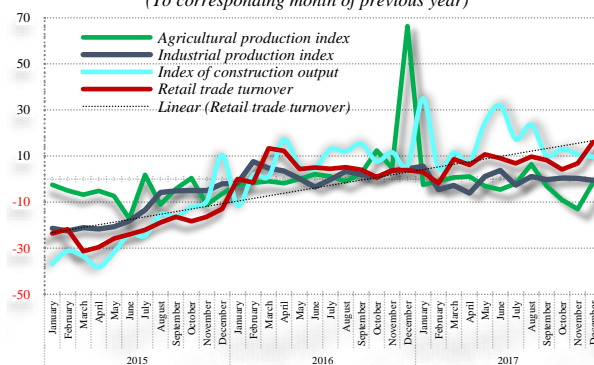
### *Economic Growth*

The State Statistical Service estimates that real GDP grew by 2.2% in 2017. This means that the Ukrainian economy has been growing for eight consecutive quarters. Nevertheless, the last quarter of 2017 showed a slowdown in the growth rate to 1.8% yoy.

High-frequency data for December 2017 show that the economic performance of Ukraine may have started to improve, principally in the service and construction sectors. In December 2017, the best output performance was in retail trade turnover, which increased by 16.1% yoy (22.2% mom). Other sectors also showed good results: construction output rose by 9.7% yoy (46.4% mom), freight and passenger turnover increased by 4 % yoy and 4.2% yoy, respectively. These positive results were supported by favorably developments in the level of nominal and real monthly average wages and salaries, which increased by 35.5% yoy (17.4% mom) and 18.9% yoy (16.2% mom). Nevertheless, Ukrainian industrial and agriculture production still showed negative results in December, with reductions of -0.5% yoy and -2% yoy, respectively.

Industrial production in December was affected by low output in electricity, gas and steam supply (-13.3% yoy) and in mining (-4.4% yoy). On the other hand, manufacturing output increased by 4.4% yoy. Within

**Economic Performance of Ukraine by Sector, % yoy**  
(To corresponding month of previous year)



Source: State Statistics Service, the Bleyzer Foundation

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manufacturing the best results took place in the production of computers and electronics (44.6% yoy); chemicals (41% yoy); basic pharmaceutical products (8.8% yoy); furniture (7.7% yoy); rubber and plastic production (3.9% yoy); basic metals (3.4% yoy); and wood, paper and printing production (2.7% yoy). On the other hand, the highest drop in manufacturing output was experienced in the production of foodstuffs (-4% yoy), and textiles (-1.2% yoy).

Regarding regional industrial output, their percent increases in December 2017 were as follows: Ternopil (29.9% yoy), Chernivtsi (15.3 % yoy), Ivano-Frankivsk (12% yoy), Lviv (11.5% yoy), Rivne (5.4% yoy), Kharkiv (5.2% yoy), Zaporizhzhya (4.7% yoy), Zakarpattia (4.5% yoy), Volyn (3.6 % yoy), Zhytomyr (2.9% yoy), Mikolayiv (2.5% yoy), Dnipropetrovsk (1.9% yoy), Kyiv (1.8%), Vinnytsya (1.5% yoy) and Sumy (0.4% yoy). On the other hand, negative signs were shown in the following regions: Lugansk (-34% yoy), Khmelnytskyi (-17.3% yoy), Donetsk (-16.2% yoy), Kirovograd (-13.3% yoy), Chernihiv (-11.8% yoy), Odessa (-9.5% yoy), Poltava (-7.5% yoy), Kyiv city (-6.3% yoy), Cherkasy (-2.7% yoy) and Kherson (-1.2% yoy).

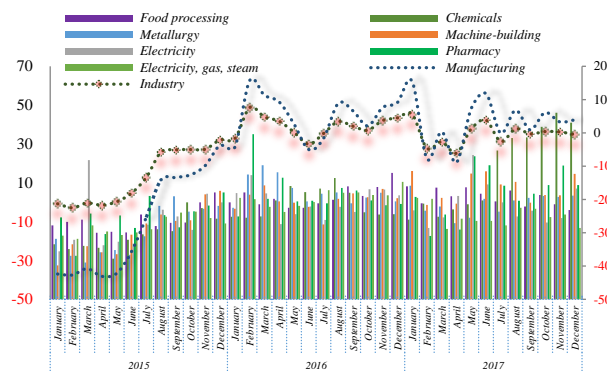
### Fiscal Policy

The state fiscal budget was in deficit in December due to lower revenues and rapid raise in expenditures. Despite higher December deficit than in the previous year, the state budget deficit for 2017 (at UAH 47.8 billion) was significantly lower than that in 2016. Furthermore, it was below the level set by the budget law (UAH 77.6 billion). The local budgets were also in deficit of UAH 22.6 billion in December. However, as they were in surplus of UAH 28.3 in January-November 2017, local budgets posted a cumulative surplus of UAH 5.7 billion in 2017. Thus, the cumulative consolidated fiscal budget was executed with a deficit of UAH 42.1 billion in 2017 (or about 1.5% of GDP, lower than the deficit agreed upon with the IMF).

State budget revenues decreased for the second consecutive month in December. The 5.6% yoy decline was driven by the negative changes in nontax revenues mainly due to statistical base effect. Tax revenues growth, though, continued to decelerate reaching 11.9%

### Industrial Production by Sectors, % yoy

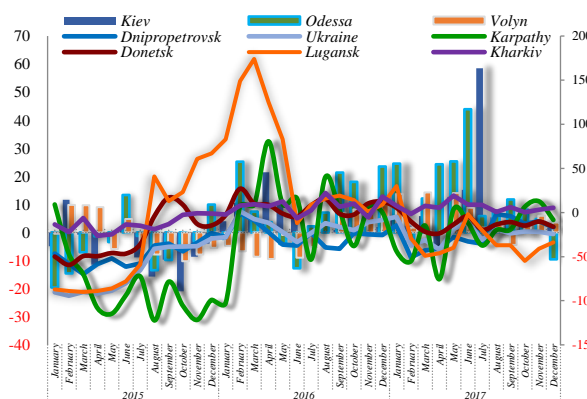
(To corresponding month of previous year)



Source: State Statistics Service, the Bleyzer Foundation

### Industrial Production by Regions, % yoy

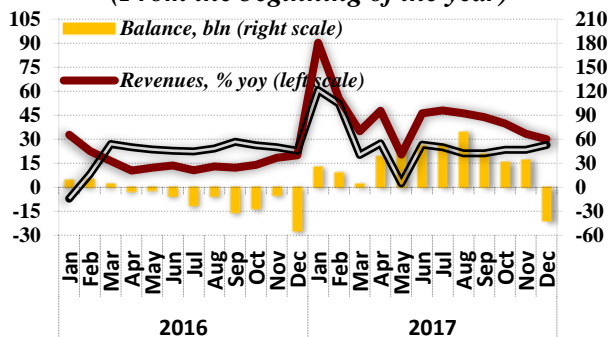
(To corresponding month of previous year)



Source: State Statistics Service, the Bleyzer Foundation

### Dynamics of consolidated budget components

(From the beginning of the year)



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

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yoy. In particular, there was deceleration in the growth of receipts from excise taxes, taxes on international trade, and personal income tax. Receipts from the VAT were the main driving force of the state budget growth during the month thanks to re-activation of retail trade and depreciation of the Hryvnia leading to increase in imports. Overall, the state budget revenues grew by 28.7% yoy in 2017. The cumulative consolidated budget revenues grew by 29.9% yoy in 2017.

Growth of the state budget expenditures significantly accelerated in December 2017. It almost doubled to 24.3% yoy due to rapid increase in expenditures on goods and services and on current transfers. Capital expenditures grew by 79.3% yoy. Payroll expenditures also posted a high growth rate. At the same time, there was deceleration in growth of expenditures on servicing of domestic debt thanks to re-profiling of domestic sovereign bonds. Growth of social security expenditures also decelerated due to lower transfers to the Pension Fund. Overall, state budget expenditures expanded a bit slower (22.5% yoy) than revenues in 2017. The cumulative consolidated budget expenditures grew by 26.4% yoy in 2017.

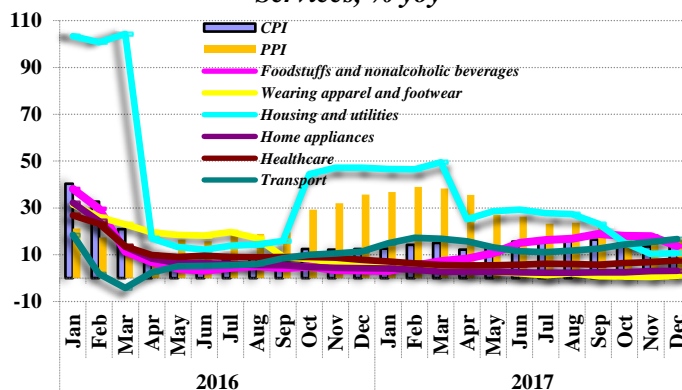
### Monetary Policy

**Inflation.** Consumer inflation remained almost unchanged in December 2017. The all items CPI index was at 13.7% yoy, significantly exceeding the NBU target of 8%±2 percentage points. The reasons for these results were decreasing supply of several types of goods due to bad weather conditions in the first half of the year, unstable situation in cattle breeding, and increase in world prices and in external demand for Ukrainian foodstuffs. There was also some pressure on the side of increasing production cost and rapid recovery of consumer demand.

Most of the major groups of goods and services saw little changes in prices in December. The largest deceleration in growth of prices was observed for alcoholic and tobacco products from 23.8% yoy to 20.7% yoy. The second largest decline was reported by communication services (from 11.5% yoy to 9.1% yoy). The effect from the mentioned deceleration in price growth was more than offset by accelerated growth in prices of transport services (from 15.4% yoy to 16.7% yoy), of restaurants and hotels services (from 16.2% yoy to 17.3% yoy), and of other goods and services (from 5.8% yoy to 7.6% yoy). The rest of the major groups of goods and services saw changes in their price growth within 0.1-0.6 percentage points.

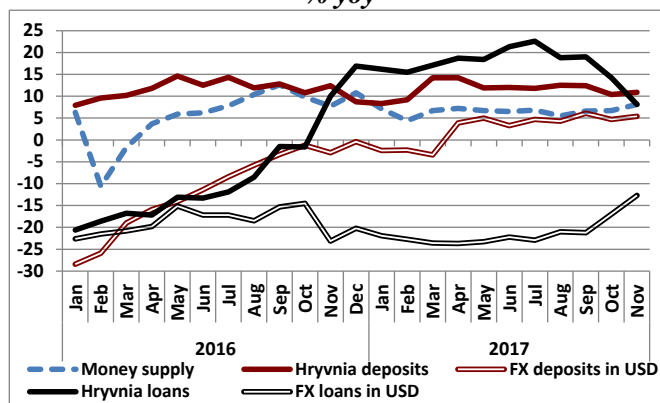
**Banking Sector.** National currency deposits further expanded in December, while foreign currency deposits denominated in USD remained almost unchanged. Increased budget spending and

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



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

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



Source: The NBU, The Bleyzer Foundation

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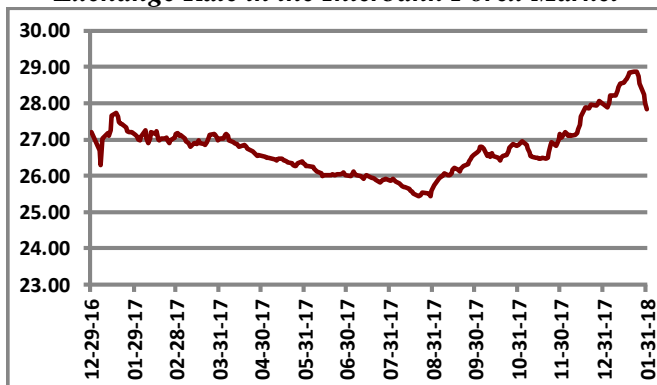
early payment of some January pensions were the major reasons of increases in Hryvnia deposits. In particular, household sector deposits grew by 19.4% yoy which is 8.0 percentage points larger than growth of corporate deposits. Low interest rates limited the growth of foreign currency deposits. Over the last couple of months, interest rates on such deposits remained at historical minimum levels. As a result, both household and corporate foreign currency deposits denominated in USD remained close to the levels observed in November 2017.

On the banking lending side, the latest available data showed accelerated growth in national currency loans thanks to loans to the household sector. At the same time, foreign currency loans continued to decline in both household and corporate sector.

Growth of cash resources together with expanding cash balances at the correspondent accounts of commercial banks led to monthly growth of the monetary base by 5.4%. At the same time, the over-year growth of the monetary base decelerated again reaching 4.6% yoy. As for the money supply, inflow of funds to deposit accounts led to its monthly growth of 6.9% accelerating the year-over-year increase to 9.5%.

**Hryvnia Exchange Rate.** Following seasonal trends, the UAH/USD exchange rate depreciated over the first three and a half weeks of January. However, the depreciation was faster than expected because of large foreign debt repayments, worsened expectations of businesses due to postponement of the next IMF tranche, and excessive hryvnia resources at the accounts of commercial banks due to huge expenditures from the government and VAT reimbursements at the end of 2017. Furthermore, the NBU made just several small-scale dollar interventions which had little effect on the exchange rate dynamics. The regulator, however, made several adjustments at the end of January which led to reversal of trend in the interbank forex market. First, the NBU issued its certificates of deposit freezing the excessive Hryvnia resources of banks. Then, the regulator raised the policy rate by 1.5 percentage points to 16% in order to return inflation to the mid-term target level. As a result, the exchange rate appreciated back to the level observed at the beginning of the month in one week.

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



Source: The NBU, The Bleyzer Foundation

### **International Trade and Capital**

In 2017, Ukraine's current account deficit amounted to USD 3.8 billion (3.7% of GDP), compared to USD 3.5 billion in 2016. The small increase in the current account deficit during 2017 was due to a slower growth of exports of goods and services (by 17.3% yoy) than of imports (which rose by 18.1% yoy.)

During the year, exports of goods increased by 19% yoy to USD 39,876 million, while goods import raised by 21% yoy to USD 49,034 million. During 2017, exports of agricultural products rose by 16.3% yoy and continued to be the largest merchandise exports, accounting for 44.5% share of the total export amount. Other sectors also performed good results representing the following growth rates: mineral products (47.1% yoy), industrial goods (24.1% yoy), ferrous and nonferrous metals (22.1% yoy), informal trade (13% yoy), chemicals products (12% yoy), machinery and equipment (9.8% yoy) and timber, with wood products (9% yoy), correspondingly.

During 2017, Ukraine merchandise imports showed a reduction only in informal products trade, which fell by -26.1% yoy. Imports of other products increased significantly, including ferrous and nonferrous metals (31.1%

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yoy), machinery and equipment (30.9% yoy), chemicals products (15.4% yoy), timber and wood products (11.2% yoy), agricultural products (10.3% yoy) and industrial goods (8.7% yoy).

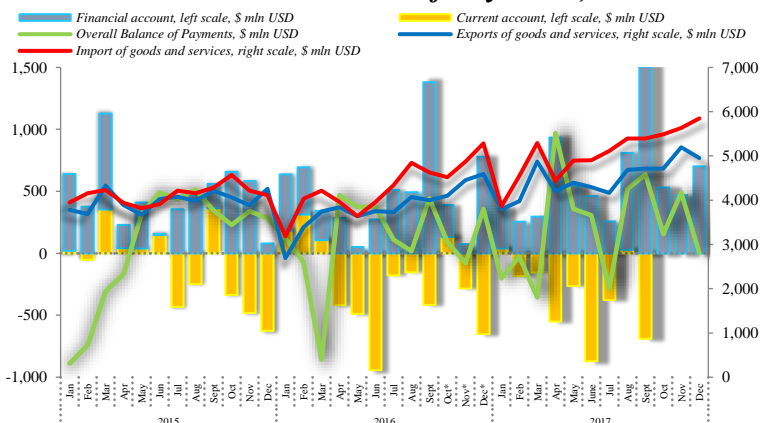
With regard to merchandise trade by country, Ukrainian merchandised export to EU countries rose by 31.9% yoy (35.4% share). Exports to Asia increased by 10.6% yoy (32.5% share), to America by 57.5% yoy (2.8% share), including to USA by 95.8% yoy (2% share), to Africa by 4.5% yoy (10.1%), and to Australia by 77.7% yoy (0.1%). In 2017, Ukraine increased exports to the Russian Federation by 10% yoy (with Russia's share falling to 8.5%.

Regarding Ukrainian merchandise imports from Russia and CIS countries, in 2017 they increased by 40% yoy and 24.3% yoy, respectively. Their share in Ukrainian imports amounted to 14.6% of total and 25.6%, respectively. Imports from the other countries also increased rapidly, as follows: from Africa by 32.7% yoy (1.2% share), Australia 19.2% yoy (0.3% share), from USA by 49.4% yoy (4.9% share), from Asia by 19.4% yoy (20.1% share) and from Europe 23.7% yoy (40.9% share).

In 2017, Ukraine's current account deficit of USD 3.8 billion was fully covered by net inflows in the financial account, which amounted to USD 6.4 billion. These financial inflows resulted mainly from private sector transactions, which amounted to USD 4.3 billion, including USD 2.3 billion in foreign direct investments.

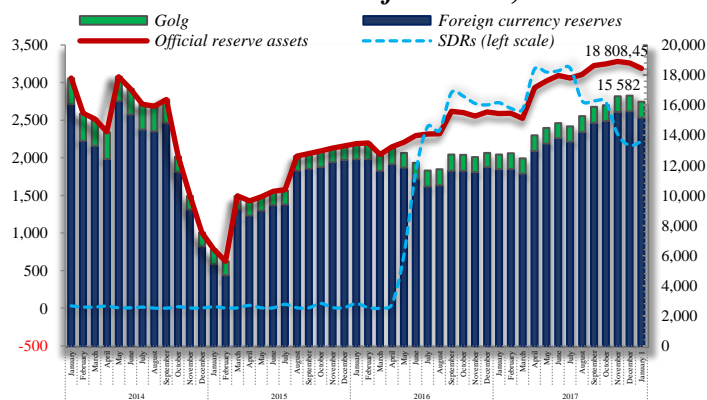
As a result, the overall surplus in the balance of payments amounted to USD 2.6 billion, which increased international reserves to USD 18.8 billion (sufficient for 3.6 months of imports).

### Ukraine's External Balance of Payments, mln USD



Source: NBU, the Bleyzer Foundation

### International Reserves of Ukraine, mln USD



Source: NBU, the Bleyzer Foundation

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