

August 2019

*Oleg Ustenko, Julia Segura, Valentyn Povrozhnyuk
Edilberto L. Segura*

Executive Summary

- ❖ President Zelenskiy's Party, Servants of the People, was able to secure 254 positions in the new Parliament, giving it a majority. The Opposition–For Life Party got 43 positions, Batkivschyna Party - 26 positions, European Solidarity Party - 25 positions, Holos Party - 20 positions, and Opposition Party - 6 positions. With a clear majority, Servants of the People will be able to appoint a Cabinet of Ministers by early September.
- ❖ In the first quarter of 2019, Ukraine's GDP grew by 2.5% yoy. On the production side of GDP, the highest rates of growth took place in construction activities (with 26.8% yoy expansion). On the expenditure side, the highest growth took place in household consumption (10.7% yoy), supported by strong growth of wages, remittances from abroad, increases of pensions and social transfers, and increases in bank lending. In June 2019, Ukraine's agriculture production expanded by 12.2% yoy while retail trade turnover increased by 13.6% yoy.
- ❖ Despite a small fiscal budget deficit in June 2019, the overall fiscal budget situation continues to be satisfactory. The cumulative fiscal budget surplus from January to June amounted to UAH 21.0 billion (1.1% of period GDP).
- ❖ Consumer inflation declined in June, with the all items index dropping 0.6 percentage points to 9.0% yoy.
- ❖ Banking deposits posted a good performance in both national currency and foreign currency sectors in June. Growth of national currency deposits accelerated by 2.9 percentage points to 8.5% yoy while foreign currency deposits denominated in USD increased for the first time in 14 months with a growth of 2.3% yoy. Bank lending activities also posted improvements in June with a growth of 4% yoy.
- ❖ The UAH/USD exchange rate appreciated by 4.2% in July. This appreciation was mainly supported by active sales of dollar by non-residents to finance purchases of Ukrainian domestic sovereign bonds denominated in hryvnia with profitability of at least 18%.
- ❖ In June 2019, Ukraine's current account of the balance of payments had a deficit of USD 432 million (compared to a deficit of USD 126 million in June 2018). This deficit was fully covered by financial inflows which reached USD 1,640 million in June 2019. These financial inflows were caused principally by portfolio investments, which amounted to USD 1,718 million in June. As result, the overall surplus of Ukraine's consolidated balance of payments amounted to USD 1,210 million in June 2019. This led to an increase in international reserves to about USD 20.6 billion, sufficient to finance imports for 3.3 months.

Main Macroeconomic Indicators	2013	2014	2015	2016	2017	2018	2019f
<i>GDP, USD billion</i>	180	130	87	93.4	113	131	146
<i>Real GDP Growth, % yoy</i>	0.0	-6.6	-9.9	2.4	2.5	3.3	3.0
<i>Fiscal Balance (incl. Naftogaz/Pension Fund), % of</i>	-6.5	-11.7	-2.1	-2.3	-1.4	-1.9	-2.3
<i>Public Debt, External and Domestic, % of GDP</i>	40.4	69.4	79.1	80.9	71.8	60.9	59.0
<i>Consumer Inflation, eop, % yoy</i>	0.5	24.9	43.3	12.4	13.7	9.8	8.0
<i>NBU Key Policy Interest Rate, % eop</i>	6.5	14.0	22.0	14.0	14.5	18.0	16.0
<i>Hryvnia Exchange Rate per USD, eop</i>	8.2	15.8	24.0	27.1	28.1	27.7	28.0
<i>Current Account Balance, % of GDP</i>	-9.2	-3.5	1.8	-1.5	-2.2	-3.3	-3.4
<i>Merchandise Exports, USD billions</i>	59	51	35	34	40	43	45
<i>Merchandise Imports, USD billions</i>	81	58	39	40	49	56	58
<i>FDI, Net Annual Inflow, USD billion</i>	4.5	0.4	3.0	3.3	2.3	2.4	2.0
<i>International Reserves, USD billion</i>	20.4	7.5	13.3	15.5	18.8	20.8	19.0
<i>Public External Debt, USD billion</i>	31.7	34.9	42.6	42.5	47.0	49.9	50.0
<i>Private External Debt, USD billion</i>	110.3	91.2	76.0	69.9	70.0	71.0	72.0

Political and Reform Developments

President Zelenskiy's Party, Servants of the People, was able to secure 254 positions in the new Parliament, giving it a majority. It was followed by the Opposition–For Life Party, with 43 positions, Batkivschyna Party with 26 positions, European Solidarity Party with 25 positions, Holos Party with 20 positions, and Opposition Party with 6 positions. Other parties, including Svoboda, Samopomich, Bila Tserkov and United Center will be represented by one Deputy each. There will be 46 independent Members of Parliament.

With a clear majority, Servants of the People will be able to appoint a Cabinet of Ministers by early September.

The President has already indicated his areas for priority reform including:

- **Free Market Reforms.** The President's Office has said that President Zelenskiy plans to implement a strong program to develop a free-and-competitive market system for Ukraine, following the successful program of Poland. The priorities would be to sell state companies, privatize state banks, create a farmland market, deregulation, and break up of monopolies.
- **Anti-Corruption.** The President has indicated that Ukraine needs more foreign direct investments to spur economic growth. He also said that potential investors are deterred by the perception that Ukrainian courts do not effectively enforce contracts and protect property rights. He said that addressing corruption will be a top priority.
- **E-Government.** The President's Office has proposed a basic framework for e-government. The State Agency for e-Governance said that 70 new priority e-services, an easy-to-use e-service portal and mobile applications, could be implemented with the assistance of international agencies by the end of the year. The key proposals included adoption of necessary laws for streamlining Ukrainian digital legislation with EU standards and opening ways towards common EU digital markets, strengthening of personal data protection and reform of the current data security system in Ukraine. The final objective is the creation of a single national website where people will perform most activities with the government, including filing taxes, registering land, securing driver's licenses, and online participation in the 2020 population census.

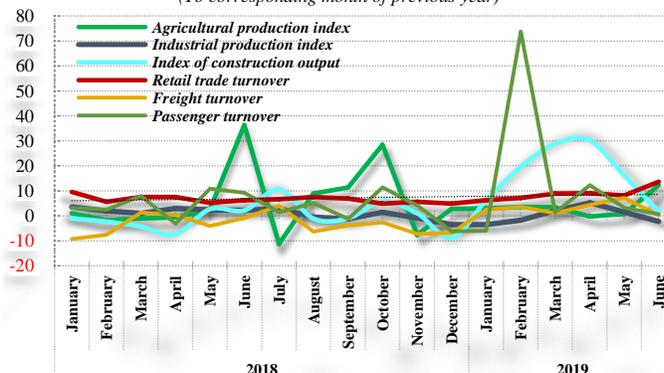
On the military front, the number of casualties in Donbas has increased, with several Ukrainian soldiers killed by Russia's proxies in the last few days. The President has requested an urgent meeting of Germany, France, Russia and Ukraine to stop these incidents. Ukraine has also sent the United States a request to buy more Javelin anti-tank systems, according to U.S. Ukraine Ambassador William Taylor.

Economic Growth

The State Statistics Committee has confirmed that Ukraine's GDP grew by 2.5% yoy in the first quarter of 2019. On the production side of GDP, the highest rates of growth took place in construction activities (with 26.8% yoy expansion). It was followed by health and social work activities (6.6% yoy increase), public administration, defense and compulsory social security (5.1% yoy), real estate activities (4.7% yoy increase), accommodation and food service activities (4.4% yoy), financial, insurance and administrative activities (4.3% yoy growth), information and communications (4.1% yoy), and agriculture, forestry and fishing (3.4% yoy).

Ukraine Economic Performance by Sector, % yoy

(To corresponding month of previous year)



Source: The Bleyzer Foundation

Headquarters

123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
Email: sbleyzer@sigmableyzer.com

Kyiv Office, Ukraine

4A, Baseyna Street, «Mandarin Plaza», 8th floor
Kyiv 01004, Ukraine
Tel: +38 (044) 284-1289
Fax: +38 (044) 284-1283
Email: kiev.office@sigmableyzer.com.ua

Kharkiv Office, Ukraine

Meytin House, 49 Sumska Street, Office 4
Kharkiv 61022, Ukraine
Tel: +38 (057) 714-1180
Fax: +38 (057) 714-1188
Email: kharkov.office@sigmableyzer.com.ua

On the other hand, the weakest performance in GDP growth during the first quarter took place in water supply and waste management activities which declined by -5.6% yoy. In addition, education diminished by -4.4% yoy. Moreover, manufacturing had a poor performance declining by -1.3% yoy, followed by electricity, gas, steam and air conditioning supply with a reduction of -4.1% yoy.

On the expenditure side of GDP, in the first quarter of the year, the largest GDP growth took place in household consumption, with a 10.7% yoy, as well as gross capital formation, which grew by 17.4% yoy. These gains were partly offset by a negative trade balance in Ukraine, despite the fact that export growth (6.8% yoy) was higher than imports increases (by 6.5% yoy). For several quarters, household consumption has been the main driver of GDP growth thanks to strong growth of nominal and real wages, large remittances from Ukrainians working abroad, increases of pensions and social transfers, and increases in bank lending. These factors are expected to continue to induce growth in the foreseeable future.

More frequent monthly output data show that the economy recovery is still ongoing. In June 2019, Ukraine's agriculture production expanded by 12.2% yoy. Comparable recovery took place in retail trade turnover, which increased by 13.6% yoy. Furthermore, the construction sector grew by 1.7% yoy in June 2019. At the same time, Ukrainian freight and passenger turnover almost did not change, with increases of 0.1% yoy and 0.6% yoy, correspondingly. On the other hand, industrial production declined by 2.3% yoy, with declines in almost in every subsector, due in part to the vacation period. Positive rates of growth were achieved only the chemicals and pharmacy sectors, with increases of 6.3% yoy and 2.2% yoy, respectively in June 2019. The most negative results in manufacturing subsectors took place in wood products (-14% yoy), machine-building (13% yoy), coke and refined petroleum products (-12% yoy), metals (-6% yoy) and foodstuffs (-0.7% yoy). Meanwhile, outside manufacturing, mining of coal as well as supply of electricity, gas and steam air conditioning improved by 4.3% yoy and 4.4% yoy, respectively.

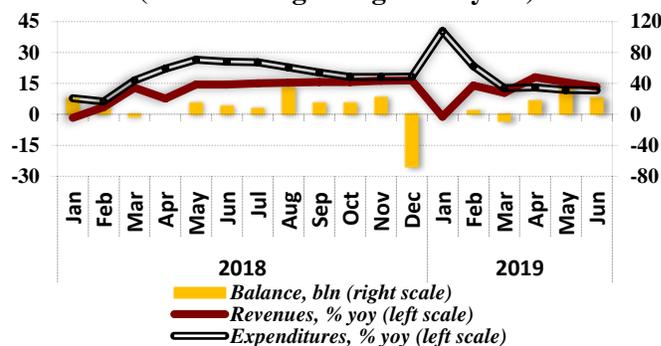
Regarding the regional distribution of industrial output, in June 2019 the most positive results took place in Vinnytsya (28.8% yoy), Lugansk (14% yoy), Sums (12.1% yoy), Dnipropetrovsk (7.8% yoy), Kirovograd (3.5% yoy), Nicholas (3.5% yoy), Ternopol (2.6% yoy), Chernivtsi (2.1% yoy) and Herson (0.2% yoy). Other regions had deterioration of industrial output in June 2019, including at Khmelnytsky (-21.9% yoy), Karpathy (-18.8% yoy), Chernihiv (-17.1% yoy), m. Kyiv (-13.4% yoy), Volyn (-11.6% yoy), Kiev (-11.3% yoy), Zhytomyr (-10.9% yoy), Zaporizhia (-10.1% yoy), Lviv (-7.2% yoy), Ivano-Frankivsk (-5.6% yoy), Donetsk (-5.1% yoy), Odessa (-5% yoy), Rivne (-3.1% yoy), Cherkasy (-2.2% yoy), Poltava (-1.9% yoy) and Kharkiv (-0.7% yoy).

Fiscal Policy

The consolidated fiscal budget balance was negative in June 2019. Slower growth of revenues led to UAH 8.5 billion deficit of the state budget. At the same time, traditionally increased payroll expenditures caused UAH 4.3 billion cumulative deficit of local budgets. The government borrowed heavily to finance the deficits. Net borrowings totaled UAH 26.4 billion. Active operations of the government, mainly through liquidity management tools, were worth of UAH 13.7 billion. The cumulative fiscal budget surplus from the beginning of the year declined to UAH 21.0 billion in H1 (1.1% of period GDP).

Growth of consolidated budget revenues continued to decelerate in June. The decline in non-tax

**Consolidated Fiscal Budget components
(from the beginning of the year)**



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

Headquarters

123 N. Post Oak Ln., Suite 410
Houston, TX 77024 USA
Tel: +1 (713) 621-3111
Fax: +1 (713) 621-4666
Email: sbleyzer@sigmableyzer.com

Kyiv Office, Ukraine

4A, Baseyna Street, «Mandarin Plaza», 8th floor
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Tel: +38 (044) 284-1289
Fax: +38 (044) 284-1283
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Meytin House, 49 Sumaska Street, Office 4
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Tel: +38 (057) 714-1180
Fax: +38 (057) 714-1188
Email: kharkov.office@sigmableyzer.com.ua

revenues of 12.7% yoy was partly offset by a 8.5% yoy growth in tax revenues, lowering the overall revenues growth only to 2.6% yoy from the 8.3% yoy observed in May. The decline in non-tax revenues was the result of lower transfers of profits from state-owned companies. Corporate profits taxes and personal income taxes ensured the highest growth in receipts (65.9% yoy and 17.8% yoy respectively). At the same time, receipts from domestic taxes on goods and services posted declines of 1.2% yoy. On the one hand, large VAT reimbursements led to a 17.0% yoy decline in the net receipts from the VAT, which more than offset a 12.7% yoy growth in receipts from excise taxes on domestic goods. On the other hand, appreciation of the exchange rate and slower growth in imports caused a 1.1% yoy decline in receipts from the VAT on imported goods and almost zero growth in receipts from excise taxes on imported goods. Cumulative consolidated budget revenues from the beginning of the year expanded at decelerated rate of 13.3% yoy in January-May.

Growth of consolidated budget expenditures significantly accelerated in June. The overall 11.3% yoy growth was caused by current expenditures as growth of capital expenditures was around zero in the reporting month. Among current expenditures, current transfers posted the largest growth of 86.4% yoy. Growth of state debt servicing expenditures accelerated from 3.7% yoy to 17.9% yoy. At the same time, payroll expenditures grew at a decelerated but still high rate of 15.1% yoy. Social security expenditures returned to growth (7.2% yoy) which was related to larger transfers to the Pension Fund as compared to the correspondent month of last year. Growth of cumulative consolidated budget expenditures from the beginning of the year slowed to 11.7% yoy.

Principal and servicing payments on the state and guaranteed debt denominated in foreign currency were lower in monthly terms in June. Total payments of USD 952.4 million equivalent consisted of USD 773.6 billion of principal and servicing payments on domestic sovereign bonds denominated in foreign currency, USD 157.5 million equivalent paid to the IMF, USD 21.3 million paid on other liabilities of foreign creditors and IFIs.

Monetary Policy

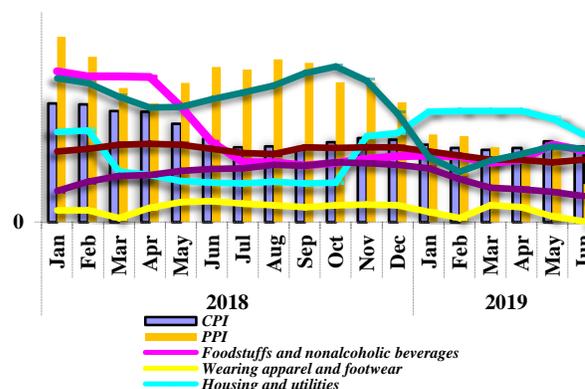
Inflation. After a month of acceleration, consumer inflation declined in June. The all items index dropped 0.6 percentage points to 9.0% yoy. Appreciation of the exchange rate and tight monetary policy were the major reasons of decline. At the same time, core inflation remained unchanged at 7.4% yoy because of continuous pressure on the side of consumer demand and production cost growth.

Prices of almost all major groups of goods and services sustained decelerated growth in in June. The most significant deceleration was recorded for housing and utilities (1.9 percentage points to 10.4% yoy), foodstuffs and nonalcoholic beverages (0.7 percentage points to 8.5% yoy), wearing apparel and footwear (0.6 percentage points to 0.1% yoy), and communication services (0.6 percentage points to 16.0% yoy). Minor acceleration in growth of prices was observed for recreation and culture (0.1 percentage point to 3.3% yoy) and healthcare (0.3 percentage points to 7.4% yoy).

As of now, we leave our forecast for inflation unchanged at 8.0% yoy at the end of the year.

Banking Sector. Banking deposits posted good performances in both national currency and foreign currency sectors in June. Growth of national currency deposits accelerated by 2.9 percentage points to 8.5% yoy thanks to positive changes in growth of both household and corporate deposits (11.8% yoy and 7.1% yoy respectively). Household deposits expanded thanks to continuous growth in wages and higher deposits profitability. Foreign currency deposits denominated in USD reversed the trend and increased for the first time

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



Source: State Statistical Service of Ukraine. The Bleyzer Foundation

in 14 months. The total growth of 2.3% yoy was ensured by increases in both household and corporate sectors (by 3.8% yoy and 1.3% yoy, respectively).

Bank lending activities also posted improvements in June. Growth of national currency loans accelerated to 4% yoy. The acceleration was fueled by large growth in household sector lending (28.1% yoy) stimulated by continuous expansion of consumer loans. The corporate sector national currency loans dropped 2.4% yoy. As for foreign currency loans denominated in USD, their decline slowed slightly, as declines in both household and corporate sectors slowed (to 15.2% yoy and 3.7% yoy, respectively)

Both monetary base and money supply expanded faster in June. The monetary base grew by 3.8 mom which led to acceleration of its over-year growth to 6.0%. Money supply increased by 2.3% mom and by 6.3% yoy.

Hryvnia Exchange Rate. The UAH/USD exchange rate remained on the appreciatory trend almost the whole July. The trend was mainly supported by active sales of dollar by non-residents to finance purchases of Ukrainian domestic sovereign bonds denominated in Hryvnia with profitability of at least 18%. Significant depreciation of the exchange rate happened only at two trading sessions during the month. The first one was related to high purchases of dollar on the side of the NBU and Naftogaz on July 10th. Another case of relatively fast depreciation was registered on July 18th and was related to the regulator’s decision on lowering the policy rate by 0.5 percentage points to 17%. Overall, the exchange rate appreciated by 4.2% in July.

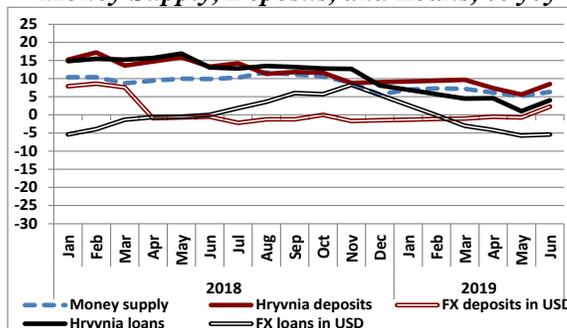
The NBU continued its reforms directed at liberalization of the foreign exchange market in July. On July 9th, the regulator lifted all the limitation of dividends repatriation for good in accordance with its road map to improve the investment climate in the country.

International Trade and Capital

In June 2019, Ukraine’s current account of the balance of payments had a deficit of USD 432 million (compared to a deficit of USD 126 million in June 2018). This monthly deficit caused a cumulative current account deficit for January-June of USD 221 million, compared to a deficit of USD 652 million in January-June 2018.

The major cause of the current account deficit in June was a decrease in merchandise exports of 6% yoy along an increase in merchandise imports of 7% yoy, which led to a negative goods trade balance of USD 1,338 million in June.

Money Supply, Deposits, and Loans, % yoy



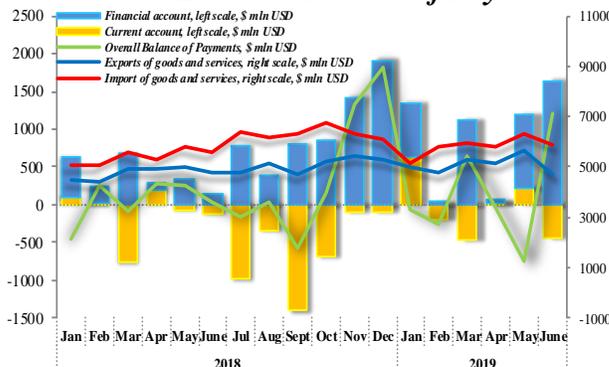
Source: The NBU, The Bleyzer Foundation

Official UAH/USD Exchange Rate (based on the 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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In June 2019, Ukraine's merchandise export amounted to USD 3,255 million. Major export declines took place in metal goods (-21.9% yoy), timber and wood products (-16.8% yoy), informal trade (-14.2% yoy) and chemical products (-12.2% yoy). Positive export growth was registered in exports of minerals (19.4% yoy), machinery and equipment (7.1% yoy), industrial goods (3.5% yoy) and agricultural products (3% yoy).

Regarding the regional destination of exports, in January-June 2019, exports to Russia declined by 16.6% yoy, and now account for 5.7 of the total exports, compared to 7.2% a year ago. On the other hand, Ukraine's exports to Europe increased by 8.7% yoy, and now represent 38.6% of the total exports, compared to 37.6%, in January-June 2019. Asia's growth in the total exports increased by 6.4% yoy and now amount to 31.7% of the total. On the imports side, in June, Ukrainian merchandise imports increased by 6.6% yoy to USD 4,593 million.

Imports increased almost in all categories of goods, with the highest increases in machinery and equipment (28.2% yoy), industrial goods (18.8% yoy), chemical products (9.6% yoy), metals (6% yoy) and food products (2.7% yoy). However, import declines were shown in mineral goods (-10% yoy), timber with wood products (-6% yoy) and informal trade (-12.2% yoy). Regional-wise, during January-June 2019, the largest drop in imports was from Russia with a reduction of 1% yoy, which brought imports from Russia to 13.3% of the total. On the other hand, imports from the EU increased by 11.3% yoy and now represent 41.6% of the total amount. Merchandise imports from Asia represented a large increase of 21.5% yoy, bringing Asia's share in the total imports amount to 23.4%, from 20.9% a year ago.

As a consequence, from the beginning of the year, the deficit in merchandise trade turnover with the Russian Federation increased by 9.8% yoy to USD 2,422 million, and its share to 46.1% of the total deficit trade turnover. In general, the share of the total amount of deficit that Ukraine incurred from trade turnover with CIS countries reached 59.32% of the total amount of deficit, with a growth of 2.7% yoy to USD 3,118 million, in January-June 2019.

On the financial account, net financial inflow reached USD 1,640 million in June 2019. These inflows were caused principally by portfolio investments, which amounted to USD 1,718 million in June. From the beginning of the year, financial inflows amounted to USD 968 million, which was similar to the amount in the same period of 2018 (0.7% yoy, USD 961 million). From January to June 2019, these financial inflows were caused by portfolio investments (USD 1,318 million) and foreign direct investments (USD 972 million.)

Due to positive inflows in the financial accounts, that fully covered the negative balances of the current account, the overall surplus of Ukraine's consolidated balance of payments amounted to USD 1,210 million in June 2019, compared to USD 23 million, in June 2018. The consolidated balance of payments in January-June 2019 reached a surplus of USD 744 million compared to a 307 million in January-June 2018. This led to an increase in international reserves to about USD 20.6 billion, sufficient to finance imports for 3.3 months.

Headquarters

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Houston, TX 77024 USA
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