December 2018

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Executive Summary

- The Martial Law imposed in 10 oblasts terminated on December 26th, paving the way for normalization of the presidential election campaign. As of January 15th, eight candidates were already registered, but many more are expected in the next few weeks. The election outcome is still quite uncertain as none of the candidates has more than 20% of support in recent polls and about one-third of the voting population is still undecided.
- Ukraine is proceeding with the creation of the High Anti-Corruption Court, a key international requirement for international support. A total of 113 candidates have presented applications for Court Judges, but the Public Council of International Experts, a foreign expert panel, has indicated that it wants to veto 47 of these candidates.
- Ukraine's economic performance during 2018 exceeded original expectations, with a likely rate of GDP growth of 3.4%, according to estimates by the NBU. This would be Ukraine's highest growth rate in seven years. This performance was achieved thanks to strong private consumption and capital investments.
- During 2018, the agricultural sector was the main economic driver, with an output growth rate of 8.2% yoy in January-November 2018. It was followed by construction output (6.3% yoy), retail trade (6.2% yoy), and passenger transportation (5.4% yoy.) On the other hand, industrial production increased by only 1.6% yoy.
- The consolidated fiscal budget had a surplus in November, expanding the cumulative consolidated budget surplus from the beginning of the year to UAH 22.0 billion (0.7 % of period GDP).
- Consumer inflation reached 9.8% in 2018, below 10% but above the target range of the NBU. Faster growth of consumer prices was the result of accelerated price growth of utilities, housing, foodstuffs, and communications.
- In the second half of November, the exchange rate depreciated due to Russia's aggression in the Azov Sea. Nevertheless, the exchange rate returned to about 27.7 UAH/USD by the end of December.
- Banking deposits and lending in Hryvnias expanded in November by 8.8% yoy and 12.7% yoy, respectively.
- The Ukrainian current account of the balance of payments had a deficit of USD 299 million (2.5% of GDP) in November 2018, which was covered by net financial account inflows of USD 1.6 billion. As a result, the overall balance of payments had a surplus of USD 1.3 billion and international reserves grew to USD 17.7 billion by early December. Disbursements from international loans brought reserves to USD 20.8 billion by the end of 2018.

Main Macroeconomic Indicators	2013	2014	2015	2016	2017	2018f	2019f
GDP, *USD billion*	180	130	87	93.4	113	125	135
Real GDP Growth, *% yoy*	0.0	-6.6	-9.9	2.4	2.5	3.4	3.0
Fiscal Balance *(incl. Naftogaz/Pension Fund),% of GDP*	-6.5	-11.7	-2.1	-2.3	-1.4	-2.5	-2.3
Public Debt, External and Domestic, *% of GDP*	40.4	69.4	79.1	80.9	71.8	65.4	64.5
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	30.0
Current Account Balance, *% of GDP*	-9.2	-3.5	1.8	-1.5	-2.2	-3.8	-3.6
Merchandise Exports, *USD billons*	59	51	35	34	40	43	46
Merchandise Imports, *USD billions*	81	58	39	40	49	55	58
FDI, *Net Annual Inflow, USD billion*	4.5	0.4	3.0	3.3	2.3	3.0	2.0
International Reserves, *USD billion*	20.4	7.5	13.3	15.5	18.8	20.8	18.0
Public External Debt, *USD billion*	31.7	34.9	42.6	42.5	47.0	47.0	48.0
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

The Martial Law imposed in 10 oblasts bordering Russia, Transnistria, and the Azov Sea terminated on December 26th. The expiration of this law paved the way for normalization of the presidential election campaign, which officially started on December 31. The Central Election Committee has already started registration of candidates running for the presidency. As of January 15th, eight candidates were already registered, including the following: Ihor Shevchenko, former Minister of Ecology and Natural Resources; Serhiy Kaplin, a member of the Ukrainian parliamentary faction of Petro Poroshenko Bloc and leader of the Social Democratic Party; Vitaliy Skotsyk, a former member of the Agrarian Party of Ukraine; Andriy Sadovyi, Mayor of Lviv and Leader of the Self Reliance party; Valentyn Nalyvaichenko: former head of the Security Service of Ukraine and former People's Deputy of Ukraine; Vitalii Kuprii, People's Deputy of Ukraine; Evgeny Murayev, People's Deputy of Ukraine; Anatoliy Hrytsenko, former Minister of Defence and leader of the Civil Position party. Other likely candidates include President Petro Poroshenko; former Ukrainian Prime Minister and Batkivshchyna party leader Yulia Tymoshenko; Serhiy Taruta, People's Deputy of Ukraine, former Governor of Donetsk Oblast and leader of the Osnova party; Yuriy Boyko, People's Deputy of Ukraine, former Minister of Fuel and Energy of Ukraine, and leader of the Opposition Platform-For life alliance; Petro Symonenko, Leader of the Communist Party of Ukraine; and Volodymyr Zelenskiy, Ukrainian showman, screenwriter, actor and art-director. The election outcome is still quite uncertain as none of the candidates has more than 20% of support in recent polls and about one-third of the voting population is still undecided.

Over the last five years, Ukraine has increased its level of security and defense capabilities to ones of the highest in Europe. These improvements are expected to ensure that Ukraine will be able to inflict significant damage to any potential outside aggressor, thereby dissuading any such attempts. Nevertheless, Ukraine is also increasing its preparedness to deal with potential outside destabilization actions, including cyber-attacks.

Ukraine is proceeding with the creation of the High Anti-Corruption Court, a key international requirement for international support. A total of 113 candidates have presented applications for Court Judges, but the Public Council of International Experts (PCIE), a foreign expert panel, has indicated that it wants to veto 47 of these candidates.

On December 18, the IMF approved a new 14-month Stand-By Arrangement (SBA) for Ukraine worth $3.9 billion. The new Program will focus on (i) continuing fiscal consolidation, (ii) reducing inflation, (iii) strengthening tax administration, (iv) improving the financial sector, and (v) ensuring energy independence of Ukraine by increasing domestic production of oil and gas. The new SBA should ensure financial stability in the country in the course of 2019.

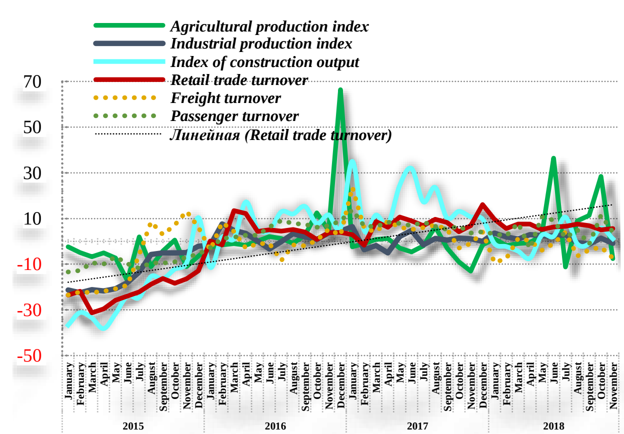
The IMF approval was the main reason for Moody's upgrading of Ukraine's sovereign credit rating from Caa1 to Caa2 with a stable outlook. In addition to the IMF loan, Moody's mentioned Ukraine's better prospects of access to capital markets, and its progress with anti-corruption reforms.

Economic Growth

Ukraine's economic performance during 2018 exceeded original expectations, with a likely rate of GDP growth of 3.4%, according to estimates by the NBU. This

Ukraine Economic Performance, % yoy

(To corresponding month of previous year)



Source: State Statistics Committee, the Bleyzer Foundation

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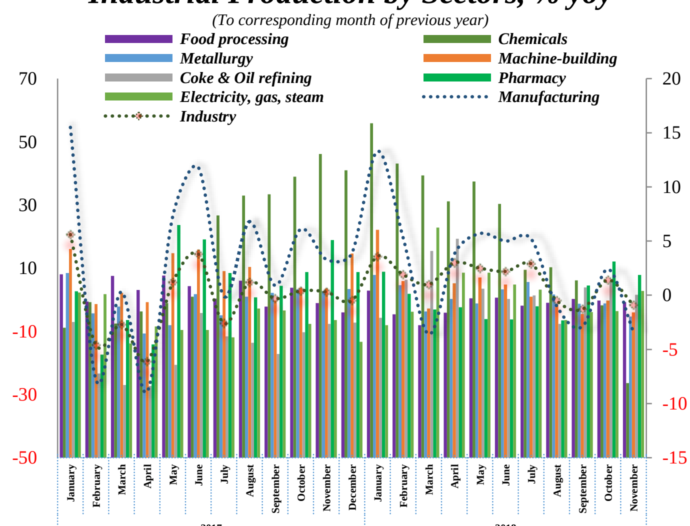
would be Ukraine's highest growth rate in seven years. This performance was achieved thanks to strong private consumption, supported by large increases in real wages, increased workers remittances, and lower inflation. In fact, private consumption increased by 9.7% yoy in the third quarter of 2018, with real wages and salaries increasing by 12.8% yoy during January-November 2018. Capital investments also performed well, with a growth rate of 19.9% yoy during January-September 2018. On the other hand, the external environment was unfavorable, with economic slowdowns in the EU and China and increased Russian aggression. As a result, the external sector performed poorly, with negative trade balances. Exports of goods increased by 10.3% yoy in January-November, below the 17.0% yoy increase in imports during the same period.

During 2018, the agricultural sector was the main economic driver, with an output growth rate of 8.2% yoy in January-November 2018. It was followed by construction output, which increase by 6.3% yoy during the eleven-month period. Retail trade turnover also performed well, with a growth rate of 6.2% during January-November. Transportation of passengers also had a good year, with a growth rate of 5.4% yoy. On the other hand, industrial production was uneven and increased by only 1.6% yoy during January-November 2018, as a consequence of weaknesses in the manufacturing subsector, which increased by only 1.2% yoy during the eleven-month period.

High frequency data for the month of November 2018 showed that the economy has remained stable thought at a low level. Retail trade turnover experienced the largest growth rate at 5.6% yoy, while construction output increased only by 1.1% yoy during the month. At the same time, Ukraine's transportation sector saw growth in passenger turnover by 4.1% yoy, despite a freight turnover reduction of 7.3% yoy. In addition, in November 2018, Ukrainian agricultural production as well as industrial output incurred negative results with declines of 7.6% yoy and 0.9% yoy, respectively.

Industrial Production by Sectors, % yoy



In November 2018, within the industrial sector, the best performing manufacturing subsectors were pharmaceutical products (7.9% yoy), furniture (6.2% yoy), coke and refined petroleum products (1.6% yoy) and wood products output (1.2% yoy). However, the other subsectors in Ukraine had negative production growth, in particular chemical products (-26.4% yoy), textile industry (-9.4% yoy), basic metals (-5.3% yoy), machinery output (-4% yoy), plastic production (-1.9% yoy) and foodstuffs (-0.8% yoy).

On a geographical basis, in November 2018 the regions with positive rates of growth in industrial output were the following: Chernivtsi (12.1% yoy), Vinnytsya (9.7%% yoy), Rivne (9.6% yoy), Mikolayiv (6.8% yoy), Kharkiv (6.6% yoy), Cherkasy (6.5% yoy), Zaporizhzhya (6.1% yoy), Zakarpattya (3.9% yoy), Kyiv city (3.6% yoy), Ternopil (2.5% yoy), Chernihiv (1.7% yoy), and Poltava (0.4% yoy). Negative rates of industrial output during November were experienced in the following oblasts: Luhansk (-35% yoy), Odesa (-13.4% yoy), Khmelnytskiy (-8.6% yoy), Volyn (-5% yoy), Kherson (-4.7% yoy), Kirovohrad (-4.3% yoy), Ivano-Frankivsk (-2.6% yoy), Donetsk (-2.4% yoy), Dnipropetrovsk (-2 % yoy), and Lviv (-0.8% yoy).

For 2019, it is expected that domestic demand will continue to be the main driver for growth, supported by increased workers' remittances, higher wages, and expenditures related to presidential and parliamentary elections. But a weaker external environment, insufficient of economic reforms, and uncertainties from elections are likely to affect growth. GDP is expected to grow by about 3.0% in 2019.

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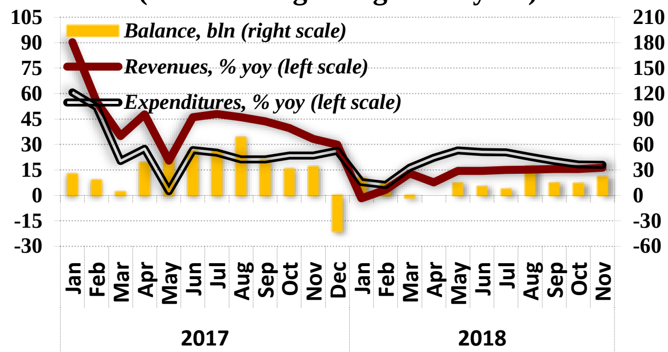
Fiscal Policy

The consolidated fiscal budget balance was positive in November, with a surplus of UAH 7.6 billion (UAH 6.0 billion in the state budget surplus and UAH 1.6 billion in the local budgets). For budget execution the government made extensive borrowings, while repayments were significantly lower. Thus, net borrowings totaled UAH 25.6 billion. At the same time, the government extracted UAH 34.0 billion of cash from from the economy. The impact of other budget financing instruments was less significant. The cumulative consolidated budget surplus from the beginning of the year expanded to UAH 22.0 billion (a surplus of 0.7% of period GDP).

***Dynamics of Consolidated Budget Components* (from the beginning of the year)**



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

Growth of consolidated budget revenues accelerated in November. The revenue growth of 21.6% yoy was caused by faster growth of both tax and nontax revenues (21.8% yoy and 21.6% yoy, respectively). Royalties posted the highest growth among the tax revenues but had insignificant impact on growth of total tax revenues due to low share (around 5%). Receipts from personal income taxes and from the single tax also posted high and accelerated growth (26.2 % yoy and 24.0% yoy respectively). Growth of receipts from the VAT on imported goods decelerated to 19.2% yoy and net receipts from the VAT on domestic goods turned negative at 16.6% yoy due to significantly higher reimbursements as compared to October. The year-to-date cumulative consolidated budget revenues grew a bit faster at 16.3% yoy in November.

Similar to revenues, growth of the consolidated budget expenditures significantly accelerated in November. The growth rate increased by almost six times to 16.7% yoy mainly on the back of expenditures on the state debt servicing, which grew rapidly by 213.2% yoy in November. Payroll expenditures also posted relatively high growth rate of 19.8% yoy among current expenditures. At the same time, current transferts and social security expenditures declined by 13.7% yoy and 21.6% yoy respectively. Growth of the capital expenditures remained high at 29.5% yoy. Growth of the cumulative consolidated budget expenditures remained almost unchanged at 18.1% yoy in January-November 2018.

The government and the NBU incurred principal and servicing payments totalling USD 1,402.3 million equivalent in November. In particular, the government spent UAH 725 million on early redemption of short-term privately placed eurobonds. Also, the government and the NBU paid UAH 439.1 million equivalent to the IMF. Finally, the government made principal and servicing payments of UAH 238.2 million on state debt denominated in foreign currency. Spending on repayment and servicing of domestic sovereign bonds equaled USD 149.1 million, while eurobond spending totaled USD 18.5 million.

Monetary Policy

Inflation. Consumer inflation reached 9.8% at the end of 2018. The increases in November and December were due to faster core inflation and growth in administratively regulated prices. In November, core inflation inched up by 0.1 percentage points to 8.9% yoy because of further increase in production cost and consumer demand. Faster growth of consumer prices was the result of accelerated price growth of foodstuffs and non-alcoholic beverages, alcoholic and tobacco products, housing and utilities, and communication which more than offset deceleration in growth of transport prices. Housing and utilities tariffs posted the fastest growth. Other major groups of goods and services saw little or no changes in price growth in November.

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Banking Sector. National currency deposits grew by 8.8% yoy in November. Hryvnia household deposits expanded fast at 16.9% yoy; but corporate deposits grew only by 1.2% yoy. Household foreign currency deposits denominated in USD also increased in November by 1.1% yoy. But the growth of corporate foreign currency deposits in USD turned negative at 6.5% yoy.

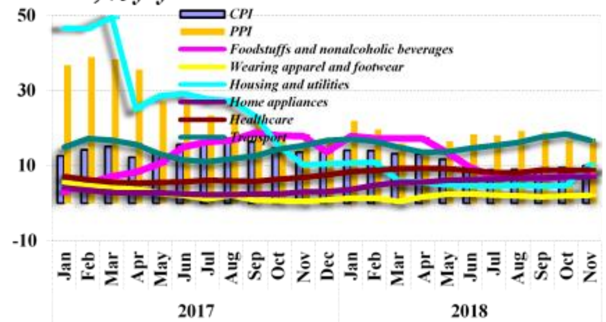
Bank lending activities in general further improved in November. National currency loans continued to grow at high rate of 12.7% yoy, while foreign currency loans denominated in USD saw faster growth at 8.3% yoy. Growth of total national currency loans was driven by household sector, growth in loans of which was at 42.6% yoy (against 6.3% yoy for the corporate sector). And vice versa, corporate sector was the major driver in growth of total foreign currency loans denominated in USD with growth of 10.3% yoy (against zero growth for the household sector). At the same time, households saw significant improvements in foreign currency loans dynamics as compared to October, when mentioned loans declined by 8.2% yoy.

The monetary base expanded by 1.8% mom in November, which led to acceleration in its year-over-year growth to 14.2%. On the other hand, the decline in deposits in banks more than offset the increase in cash resources out of banks. Thus, money supply shrank by 1.3% mom in November, slowing the year-over-year growth to 8.8%.

Hryvnia Exchange Rate. After a short depreciation period at the end of November caused by the conflict in the Azov Sea, the UAH/USD exchange rate reversed the trend at the beginning of December, ending the year at 27.7 UAH/USD. The appreciatory trend was supported by uncommonly low demand for dollar by non-residents and importers. Then, the exchange rate remained relatively stable during the second decade of the month. The positive decision of the IMF regarding the new Stand-By Arrangement for Ukraine and early arrival of the first tranche within the program led to another wave of the exchange rate appreciation which lasted almost by the end of the year.

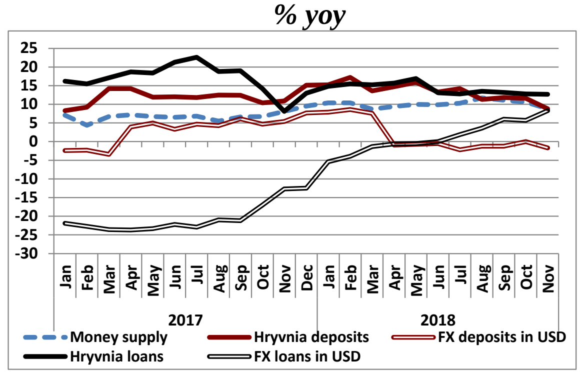
Thanks to the new tranche from the IMF and related financial assistance from the World Bank and the EU and purchases of dollar at the interbank forex market to smooth appreciatory fluctuations, the NBU managed to build up the international reserves to USD 20.8 billion which is the highest level since October 2013.

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

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

Source: The NBU, The Bleyzer Foundation

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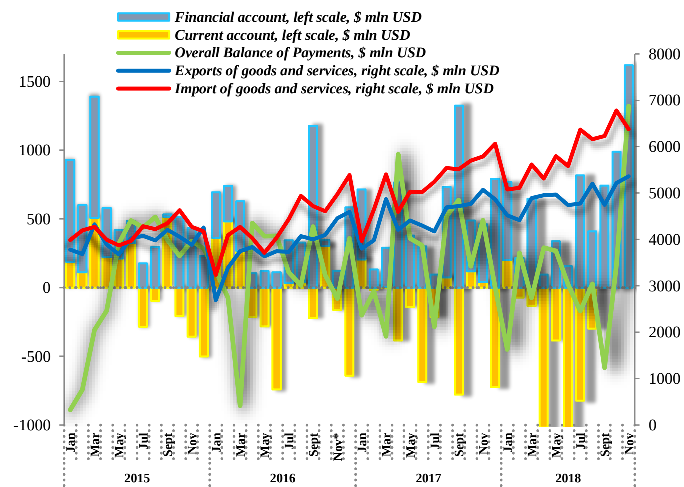
International Trade and Capital

Ukraine's External Balance of Payments, mln USD



Source: NBU, The Bleyzer Foundation

In November 2018, the Ukrainian current account of the balance of payments had a deficit of USD 299 million (2.5% of GDP), which was lower than the deficit of USD 823 million experienced in October 2018. The cumulative deficit from January to November 2018 reached USD 4.4 billion (3.8% of GDP).

The November, the current account deficit was covered by net financial account inflows of USD 1.6 billion, principally in the form of net inflows of net foreign direct (USD 301 million) and portfolio (USD 1.2 billion) investments.

As the result, Ukrainian overall balance of payments had a surplus of USD 1.3 billion, which grew the international reserves of Ukraine to USD 17.7 billion (3 months of imports) by early December. Disbursements from international loans brought reserves to USD 20.8 billion by the end of 2018.

The improvement in the current account in November were due to surpluses in the primary and secondary income balances of USD 429 million and USD 288 million, respectively. Trade in goods and services also developed favorably. During the month of November, exports of goods and services raised by 2.8% mom to USD 5.5 billion, whereas imports of goods and services declined by 5.9% mom to USD 6.4 billion.

On a year-over-year basis, during November 2018, merchandise exports grew by 6.2% yoy, to USD 4.0 billion (or 2.8% mom). The major export growth was in mineral products (which increased by 29.1% yoy), followed by agricultural goods (27.2% yoy), wood products (10.8% yoy) and industrial products (3.9% yoy). On the other hand, Ukrainian merchandise export suffered reductions in metallurgical goods (-24.3%), informal trade (-26.4% yoy), chemical goods (-7.1% yoy), as well as machinery and equipment (-4.8% yoy). Regarding Ukrainian merchandise imports, its growth in November amounted of 12.7% yoy (to USD 5.3 billion) and was due to increased purchases of machinery and equipment (23.5% yoy increase), metallurgy goods (20.4% yoy), industrial goods (18.6% yoy), mineral products (17.6% yoy), wood products (10.9% yoy), agricultural goods (4.1% yoy) and chemicals (0.6% yoy). Only informal trade in Ukrainian merchandised imports showed negative results (-9.1 % yoy).

In January-November 2018, Ukrainian merchandised trade deficit expanded by 41% yoy, to USD -11.8 billion, compared to a deficit of USD -8.4 billion during the same eleven month of the previous year. The bulk of this trade deficit (about 57%) was due to the trade deficit of Ukraine with CIS countries. Within the CIS countries, about 70% of the trade deficit was caused by trade with the Russian Federation (USD -4.6 billion).

On the other hand, Ukraine's exports to Europe increased by 16.6% yoy, to USD 15.2 billion (38.4% of total exports), while goods import from Europe grew by 12.1% yoy, to USD 20.6 billion (40.2% of total import amount).