

March 2019

*Oleg Ustenko, Julia Segura, Valentyn Povrozhnyuk  
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### *Executive Summary*

- ❖ Ukraine's Presidential election is scheduled for March 31, the last Sunday of the month. The outcome of the elections is still uncertain as the most recent polls still contains a large number of undecided voters, the ratings of the three main candidates are still close, and the individual ratings are unreliable and changing quickly from day-to-day. All these uncertainties suggest that a second-round, preliminary scheduled for April 21, will be inevitable.
- ❖ Nevertheless, all major rating agencies give Volodymyr Zelensky, a comedian actor, an advantages in the first round. In addition to Mr. Zelensky, two other candidates follow him closely, former Prime Minister Yulia Tymoshenko and President Petro Poroshenko. Either of the two could move to the second round.
- ❖ Following acceleration of economic growth during the last quarter of 2018, the most recent monthly data show a mixed situation. On the one hand, industrial production declined by 3.3% yoy in January. On the other hand, in January 2019, real trade turnover grew by 6.3% yoy, agricultural production advanced 3.0% yoy, and construction output increased by 6.2% yoy.
- ❖ The consolidated fiscal budget incurred a small deficit of UAH 0.4 billion in January. A high cumulative surplus of local budgets (UAH 11.5 billion) was more than offset by a state budget deficit (UAH 11.9 billion).
- ❖ Consumer inflation decelerated in January. The index declined by 0.6 percentage points to 9.2% yoy. This deceleration was mainly the result of lower fuel prices.
- ❖ National currency bank deposits posted accelerated growth in January 2019 thanks to both corporate and household sectors. The former reported a 10.2% yoy growth, while the later had a 15.6% yoy growth.
- ❖ The UAH/USD exchange rate appreciated at the beginning of February and then remained relatively stable by the end of the month at about 27 UAH/USD.
- ❖ In January 2018, the current account of the balance of payments had a surplus of USD 446 million, thanks to a higher growth in exports of goods and services (9% yoy to USD 4.9 billion), than in imports, which increased by 2% yoy (to USD 5.2 billion). With a slightly higher level of outflows in the financial account, the overall balance of payments had a small deficit of USD 68 million. International reserves remained at about USD 20 billion.

<i>Main Macroeconomic Indicators</i>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>	<b>2019f</b>
<i>GDP, USD billion</i>	180	130	87	93.4	113	125	135
<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	62.6	64.5
<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	30.0
<i>Current Account Balance, % of GDP</i>	-9.2	-3.5	1.8	-1.5	-2.2	-3.7	-3.6
<i>Merchandise Exports, USD billions</i>	59	51	35	34	40	43	46
<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	18.0
<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

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### **Political and Reform Developments**

Ukraine’s Presidential election is scheduled for the last Sunday of the month, on March 31. The outcome of the elections is still uncertain as the most recent polls still contains a large number of undecided voters, the ratings of the three main candidates are still too close, and the individual ratings are unreliable and changing quickly from day-to-day. All these uncertainties suggest that a second-round, preliminary scheduled for April 21, will be inevitable.

Nevertheless, all major rating agencies give Volodymyr Zelensky, a comedian actor, an advantages against the other candidates in the first round. In addition to Zelensky, two other candidates follow him closely, former Prime Minister Yulia Tymoshenko and President Petro Poroshenko.

Mr. Zelensky’s higher ratings are possibly due to general dissatisfaction with the poor economic performance of the country, the ongoing territorial disputes with Russia and recent corruption scandals involving high level government officials. Zelensky is running on an anti-establishment and anti-corruption agenda. However, he is also seen as lacking experience. Nevertheless, he is likely to move to the second election round on April 21.

President Petro Poroshenko is running on a pro-Western agenda, a strong anti-Russia position, and a nationalistic Ukrainian religious stance. However, his campaign is suffering from the recent corruption scandals. The former Prime Minister Yulia Tymoshenko has a poll ranking similar to President Poroshenko, and either of the two may move to the second election round. Ms. Tymoshenko also has a pro-Western stance, but her populist economic proposals have raised concerns among the more conservatives segments of the population.

Irrespective of the outcome, current strict monitoring from international donors and the necessity for Ukraine to obtain new loans to cover considerably higher external repayments this year will limit the new President’s policymaking, or risk losing vital financial support programs, at least in the short-term. Over the longer term, the new government will need to accelerate economic, legal and judicial reforms to improve the business environment, which is needed to increase investments and productivity and achieve higher rates of economic growth. In particular, the World Bank and the G7 on March 4 urged Ukrainian authorities to reinstate the law imposing criminal liability for illicit enrichment, calling its cancellation by the Supreme Court “a serious setback in the fight against corruption in Ukraine.”

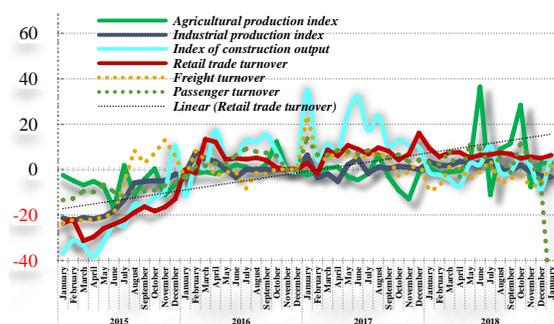
In the recently published Corruption Perception Index 2018 of Transparency International Ukraine was ranked as 120 out of 180 countries (compared to 130 a year ago). Despite the 10 points improvement over the previous ranking, Ukraine still has a long way to go to reach the level of Western democracies. Significant improvements in this area are proposed by all candidates and the new President’s position will be closely watched by the international community and Ukrainian civil society. The recent Stand-by arrangement with IMF clearly defines fighting corruption as one of the most important goals for improving the business climate in Ukraine.

### **Economic Growth**

Following acceleration of economic growth during the last quarter of 2018, the most recent monthly data on economic performance in 2019 show a mixed situation. On the one hand, industrial production declined by 3.3% yoy in January. On the other hand, real trade turnover grew by 6.3% yoy, in January, supported by stable prices, stable

**Economic Performance of Ukraine by Sector**

(To corresponding month of previous year, % yoy)



Source: State Statistics Service, the Bleyzer Foundation

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foreign exchange rates, raising real wages, and increased workers remittances from abroad. Furthermore, agricultural production advanced 3% yoy in January 2019, compared to 1.1% yoy, in January 2018. In addition, during the month, Ukrainian construction output increased by 6.2% yoy, compared to a reduction of 1% yoy in January 2018.

Within the industrial sector, both mining and manufacturing contracted in January (by -1.6% yoy and -5.5% yoy, respectively), whereas electricity and gas supply grew by 1.3% yoy. With regard to the manufacturing sector, only one sector showed positive results: basic pharmaceuticals production advanced by 6.6% yoy, in January 2019. The other industrial sectors diminished their outputs, as follows: chemicals (-14.9% yoy), machinery and equipment (-11.9% yoy), textiles (-9.7% yoy), plastic & rubber (-6.5% yoy), wood products (-5.9% yoy), metallurgy (-4.5% yoy), coke and refined petroleum products (-3.6% yoy), foodstuffs (-1.9% yoy), and furniture (-1.6% yoy).

From a regional viewpoint, a number of oblasts showed good results in industrial output, in particular: Rivne (22.8% yoy), Vinnytsya (13.8% yoy), Zakarpattya (9.6% yoy), Kherson (5% yoy), Cherkasy (2.3% yoy), Kyiv (2% yoy), Poltava (1.7% yoy), Odesa (1.2% yoy), Donetsk (1.1% yoy) in January 2019.

However, these positive results were overshadowed by negative industrial output growth in other oblasts, as follows: Chernihiv (-17.4% yoy), Khmelnytskyi (-15.5% yoy), Luhansk (-13% yoy), Zhytomyr (-7.5% yoy), Kirovohrad (-7.3% yoy), Zaporizhzhya (-5.9% yoy), Lviv (-5.7% yoy), Ivano-Frankivsk (-5.1% yoy), Mikolayiv (-4.8% yoy), Volyn (-3.8% yoy), Dnipropetrovsk (-2% yoy), Kyiv city (-1.8% yoy), Ternopil (-1.7% yoy), Kharkiv (-1.2% yoy), Sumy (-1.1% yoy), Chernivtsi (-0.4% yoy).

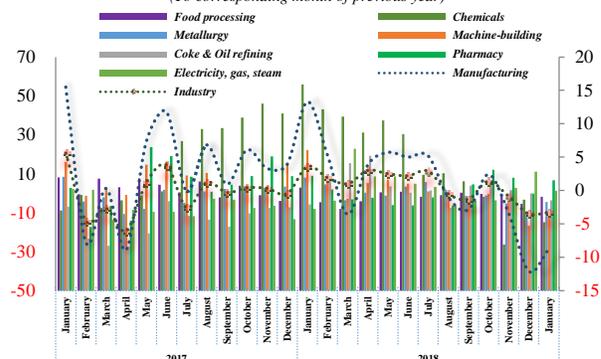
Ukrainian domestic investment continued to show sluggish growth due to political uncertainties related to the Presidential and Rada elections, as well as revelations of major corruption scandals.

### **Fiscal Policy**

The consolidated fiscal budget incurred a small deficit of UAH 0.4 billion in January. A high cumulative surplus of local budgets (UAH 11.5 billion) was more than offset by the state budget deficit (UAH 11.9 billion). The later was the result of some decline in revenues accompanied by acute increase in expenditures. To finance budget execution, the government borrowed heavily; but also repaid previously taken loans.

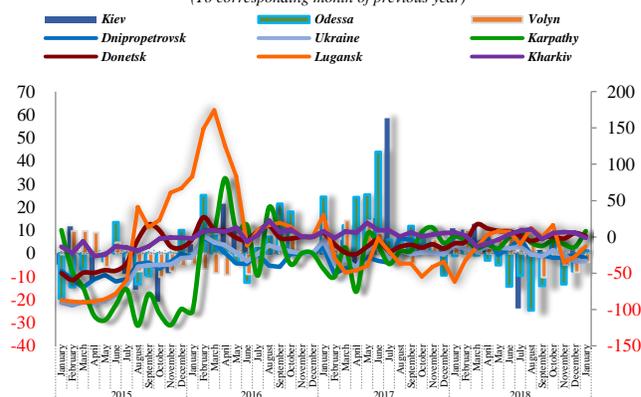
As a result, net borrowings were low at UAH 1.3 billion. The government also pumped UAH 3.7 billion of cash into the economy. But extracted UAH 4.8 billion through its liquidity regulating instruments.

### **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

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Consolidated budget revenues in January posted a decelerated growth of 3.6% yoy due to lower growth in tax revenues (which expanded just by 2.1% yoy). This was the result of economic developments and temporary factors. In particular, high VAT reimbursements led to negative growth of total VAT receipts and negative contribution to growth from domestic taxes in general (which declined by 16.5% yoy). Taxes on imported goods made small but positive contribution to growth, despite weak imports and hryvnia strengthening. Receipts from personal income tax and corporate profit tax continued to grow at high rates (22.8% yoy and 52.1% yoy respectively). Nontax revenues grew by 21.9% yoy.

Growth of consolidated budget expenditures rapidly accelerated in January. The 46.2% yoy growth was the result of fast growth in both current and capital expenditures. The former were driven mainly by social security expenditures (124% yoy growth.) In particular, transfers to the Pension Fund rapidly increased because of continued growth in pensions of some categories. Current transfers continued to grow fast (by 60.3% yoy), mostly at the local level, despite lower number of households receiving housing and utility subsidies. Also payroll expenditures and expenditures on goods and services posted high growth rates (25.8% yoy and 15.8% yoy respectively). Capital expenditures increased by 67.9% yoy.

Principal and servicing payments on state and guaranteed debt denominated in foreign currency significantly increased in January. They reached USD 883.9 million equivalent. The vast majority of this amount was spent on principal and servicing payments on domestic sovereign bonds – USD 808.1 million.

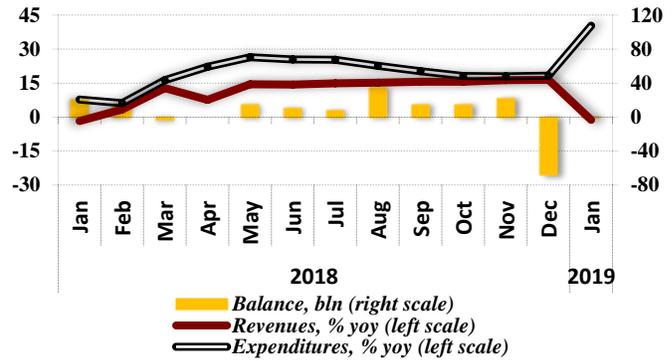
### Monetary Policy

**Inflation.** Consumer inflation decelerated in January. The total items index inched down by 0.6 percentage points to 9.2% yoy. This deceleration was mainly the result of lower fuel prices and slower growth in prices of goods and services used for calculation of the core inflation. Core inflation decelerated by 0.4 percentage points to 8.3% yoy.

Only several major groups of goods and services posted notable changes in price dynamics in January. The most significant acceleration in price growth was observed in housing and utilities (by 2.5 percentage points to 13.1% yoy). A deceleration in price growth was reported for transport (by 5.2 percentage points to 7.7% yoy), wearing apparel and footwear (by 0.8 percentage points to 1.2% yoy), and restaurants and hotels (by 0.6 percentage points to 12.4% yoy).

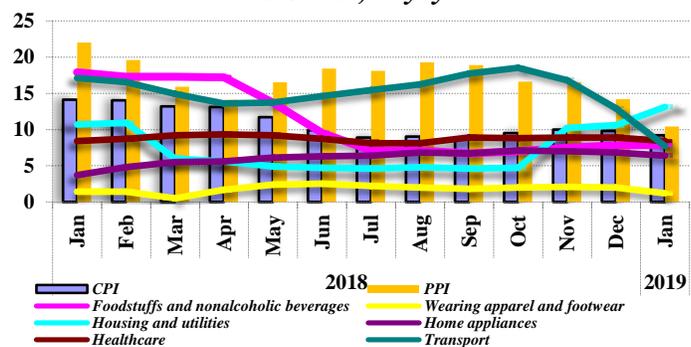
**Banking Sector.** National currency deposits posted accelerated growth in January thanks to both corporate and household sectors. The former reported a 10.2% yoy growth, while the latter – a

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



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

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



Source: State Statistical Service of Ukraine, The Bleyzer Foundation

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15.6% yoy growth. This was the result of budget operations, further expansion of wages and pensions, and growth in profitability of deposits.

Crediting activities of banks was relatively weak due to seasonal factors in January. In particular, lower business activities during the month led to a decline of the national currency corporate loans, which more than offset growth of the correspondent loans of the household sector.

Seasonal decline in cash resources during after New Year holidays led to monthly decline of monetary base by 1.6% in January. The over-year growth of monetary base, however, remained almost unchanged at 9.3%. Growth of money supply, in contrast, accelerated to 7.0% yoy on the back of faster expansion of total deposits denominated in UAH.

**Hryvnia Exchange Rate.** The UAH/USD exchange rate appreciated at the beginning of February and then remained relatively stable by the end of the month. Appreciation was the result of lower than expected demand for dollar on the side of non-residents who usually increase dollar purchases at the beginning of each month for dividends repatriation purposes. Probably, this was because of placements of domestic sovereign bonds denominated in UAH by the Ministry of Finance. High profitability of bonds attracted many foreign investors.

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



Source: The NBU, The Bleyzer Foundation

The National Bank further liberalized foreign currency market regulations starting on February 7<sup>th</sup>. Changes were related to foreign operations of both businesses and population. As for business operations, one of the most important changes was the lowering of the share of foreign currency revenues obligatory for sale at the interbank forex market from 50% to 30%. Also, the regulator lifted requirement for obligatory reservation of hryvnia funds for further purchases of foreign currency. Banking businesses lobbied for simplification of some requirements related to foreign currency supervision by banks. The population now can make online foreign currency purchases equivalent to UAH 150 thousand per calendar day. At the same time, the regulator banned transferring funds for the purposes of providing loans, making investments to the country aggressor/occupant, offshore zones, and countries which do not follow recommendations of FATF. Also, the NBU temporarily preserved limitations on purchases by banks of external sovereign bonds of Ukraine.

### **International Trade and Capital**

According to the NBU, in January 2019, the current account of the balance of payments had a surplus of USD 446 million, compared to a surplus of USD 119 million in January 2018. The current account surplus was due to a higher growth in exports of goods and services (9% yoy to USD 4.9 billion), than in imports, which increased by 2% yoy (to USD 5.2 billion). The increase in the deficit in goods trade (by 46% yoy to USD 314 million) was the result of higher merchandise import (USD 4 billion; 1.2% yoy), than export of goods (USD 3.7 billion; 9.1% yoy).

Ukrainian exports are currently dominated by agricultural exports, which account for 46.6% of total exports (with a January growth rate of 22.9% yoy). Metallurgical exports grew by 7.8% yoy in January and now account for 28.5% of exports. Exports of industrial goods grew by 18.6% yoy in January and now represent

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1.3% of the total exports.

On the other hand, chemical exports declined by 24% yoy in January and now account for only 3.1% of exports. Mineral exports fell by 0.4% yoy in January, and its share is now 8.4% of the total. At the same time, machinery & equipment dropped by 16.4% yoy and reached 5.1% of the total export.

From a geographical point of view, in January 2019 Ukraine exports to Russia amounted to USD 163 million and fell by -23.5% yoy. They now represent 4.4% of total exports, compared to 6.2% in January 2018. Exports to Asia increased by 1.7% yoy, representing 30% of the total Ukrainian exports. Exports to Europe increased by 8% yoy and now account for 41.5% of exports (compared to 42%, in January 2018).

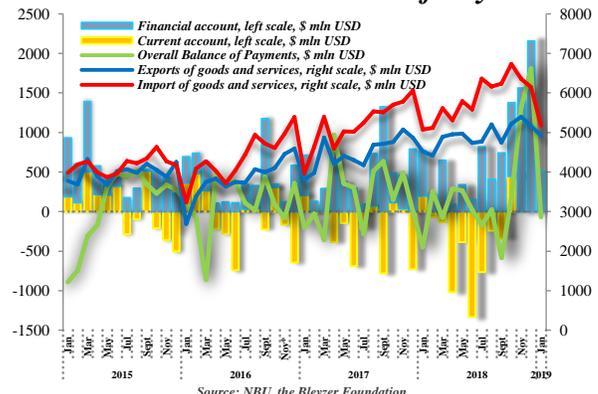
With regard to merchandise imports, in January 2019, machinery and equipment accounted for the major share (29.4% of the total import amount), particularly energy imports, which increased by 21.7% yoy. The second largest product category was mineral products, which accounted for 22.6% of the total imports, but fell down by 9% yoy in January. Imports of chemical products are the third largest import category which also declined by 9.3% yoy in January and now represent 18.8% of the total imports. Agricultural imports represent the fourth largest import group (with 10.7% of the total) and increased by 9.6% yoy in January.

Geographically, Europe is the largest supplier of goods to Ukraine, with a 37.6% share; followed by Asia with a 24.6% share. The share of Russia in Ukrainian imports has been reduced to 14.6% of the total (to USD 589 million), compared to 17.3% (USD 689 million) in January 2018.

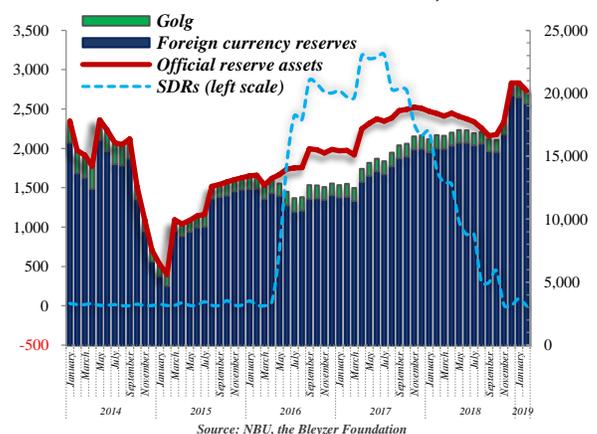
In January 2019, the financial account showed net outflows of USD 509 million, compared to outflows of USD 568 million in January 2018. The major outflow were due to government repayments of portfolio security debt (USD 200 million), and trade credits (USD 453 million) in January 2019. In addition, foreign direct investments net inflows reached only USD 168 million.

As the result, the surplus in the current account (USD 446 million) was not able to compensate deficit in the financial account (USD 509 million) and the overall balance of payments had a small deficit of USD 68 million in January 2019, slightly lowering international reserves to USD 20.2 billion as of 1st of February 2019 (5 months of imports).

**Ukraine's External Balance of Payments**



**Ukraine's International Reserves, mln USD**



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