

Ukraine Economic Situation and Reforms

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Ukraine – Economic Indicators, as of Sept. 2016

Annual Indicators	2012	2013	2014	2015	2016	2017	2018	2019	2020
GDP (USD bn)	173,0	180,0	130,0	98,0	95,0	101,0	108,5	118,8	128,8
Economic Growth (GDP, annual var. in %)	0,2	0,0	-6,6	-9,9	1,5	3,0	4,0	5,0	5,5
Domestic Demand (annual var. in %)	5,2	1,0	-12,1	-8,0	1,6	4,0	5,0	6,0	7,0
Private Consumption (annual var. in %)	8,4	6,9	-8,3	-20,2	1,5	3,5	4,5	5,5	6,5
Fixed Investment (annual var. in %)	5,0	-8,4	-24,0	-9,3	2,0	3,0	4,0	5,0	6,0
Industrial Production (annual var. in %)	-0,5	-4,3	-10,1	-13,0	2,5	4,5	5,5	6,5	7,5
Unemployment (% of active population, eop)	7,5	7,2	9,3	10,3	9,5	9,0	8,5	8,0	7,5
Fiscal Balance (% of GDP)	-5,5	-6,5	-11,7	-8,0	-4,0	-3,1	-2,6	-2,0	-2,0
Public Debt (% of GDP)	36,6	40,4	69,4	79,4	84,4	81,7	81,0	79,0	79,0
Inflation (CPI, annual variation in %, eop)	-0,2	0,5	24,9	43,3	12,0	10,0	8,0	8,0	5,0
Exchange Rate (UAH per USD, eop)	8,05	8,24	15,8	24	27	28	29	30	30
Current Account (% of GDP)	-8,3	-9,0	-4,1	0,0	-2,0	-2,0	-0,5	-0,5	-0,5
Merchandise Trade Balance (USD bn)	-20,5	-20,0	-6,1	-0,8	-3,0	-3,0	-1,0	-2,0	-2,0
Merchandise Exports (USD bn)	69,8	65,0	55,6	49,8	52,0	56,0	60,0	64,0	68,0
Merchandise Imports (USD bn)	90,3	85,0	61,7	50,6	55,0	59,0	61,0	66,0	70,0
International Reserves (USD bn)	24,5	20,4	7,5	13,3	17,0	20,0	28,0	30,0	32,0
External Debt (USD bn)	135,1	142,5	134,0	138,0	156,0	162,0	155,0	150,0	145,0

Source: State Statistics Committee, NBU, The Bleyzer Foundation

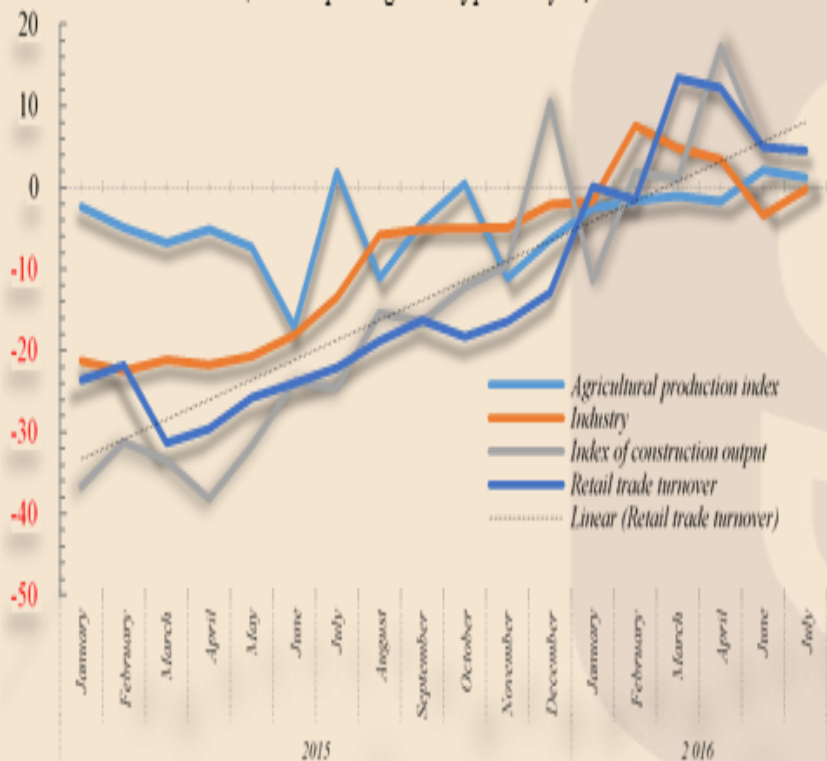
Military Situation

- The intense military actions experienced in Eastern Ukraine during August calmed down in September, but restarted thereafter.
- International observers has reported an increase in the volume of Russian arms and weapons held by separatists in Donetsk and Luhansk.
- Moreover, there is also an increase in a number of Russian military forces at the border with Donbas and at the temporary border with Crimea.
- Russia has explained these buildups as routine military training operations.
- But these actions have raised concerns about Russia's intentions, with Poroshenko warning that "a full-scale invasion from Russia could be on the horizon."
- As a reaction to this risk, the Ukrainian Ministry of Defense announced 10-day training for 80,000 reservists who already have military experience.
- The President has also put the Ukrainian army on high alert and stated that he will call for martial law and mobilization if the conflict escalates.
- Ukraine was in the agenda of the latest G-20 meetings in China. The US and the EU leaders re-confirmed their support to Ukraine's territorial integrity.

Economic Growth

Economic Performance of Ukraine by Sector, % yoy

(To corresponding month of previous year)

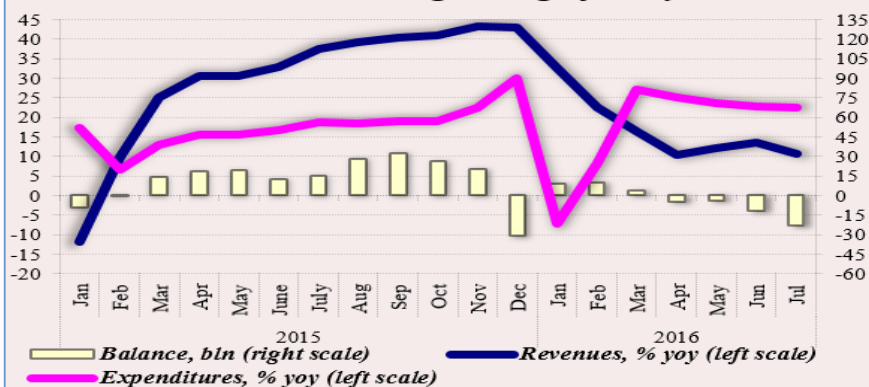


Source: The Bleyzer Foundation

- Despite the recent political/military crises, the economy is recovering, though from a low base.
- For the first time in 3 years, since February industrial output growth has been largely positive (except for June).
- Agriculture, construction and trade also showed positive growth rates.
- In January-July industrial output increased by 1.7% yoy (compared to the same period last year.)
- All three subsectors of industry, mining, manufacturing, and gas- electricity showed positive growth.
- Following a decline of 9.9% in 2015, GDP is expected to grow by 1.5% in 2016 and 3.0% in 2017.

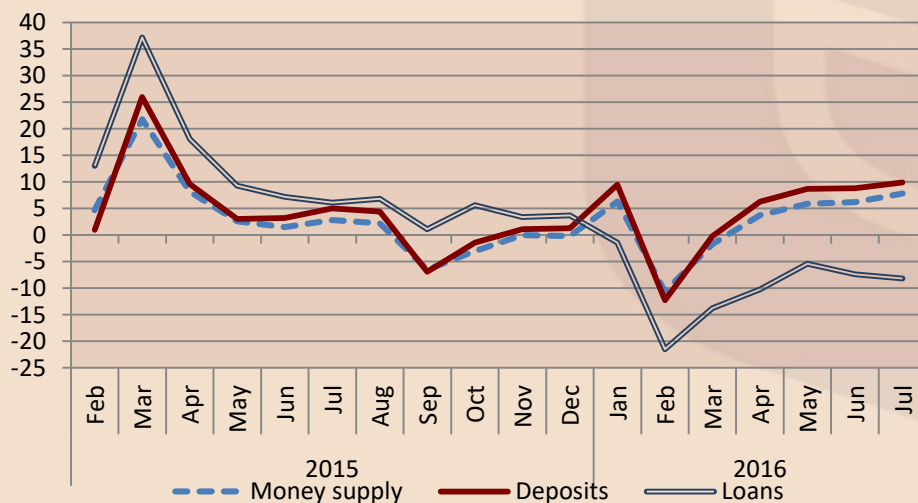
Fiscal & Monetary Policies

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



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

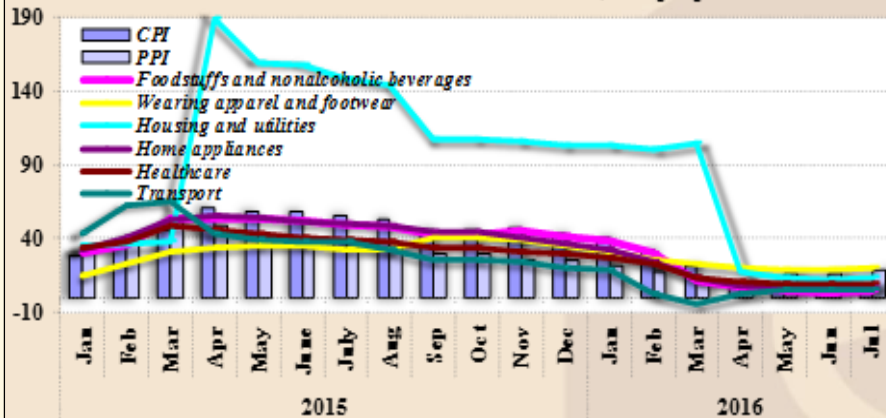
Money Supply, Bank Deposits, and Bank Loans; % yoy growth



- The consolidated fiscal budget deficit amounted to UAH 22.9 bn for January-July 2016 (about USD 0.9 bn).
- This deficit is still satisfactory at about 1.7% of GDP; but may reach 4% of GDP by year-end as planned.
- Monetary policies have been prudent, with money supply increasing by about 5%-7% pa.
- Deposits in the banking sector continued to expand in July, growing by 10% yoy and by 5% yoy since January 2016.
- Bank lending activities have posted more sluggish performance declining by 8% yoy in July.

Inflation and Foreign Exchange Rate

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



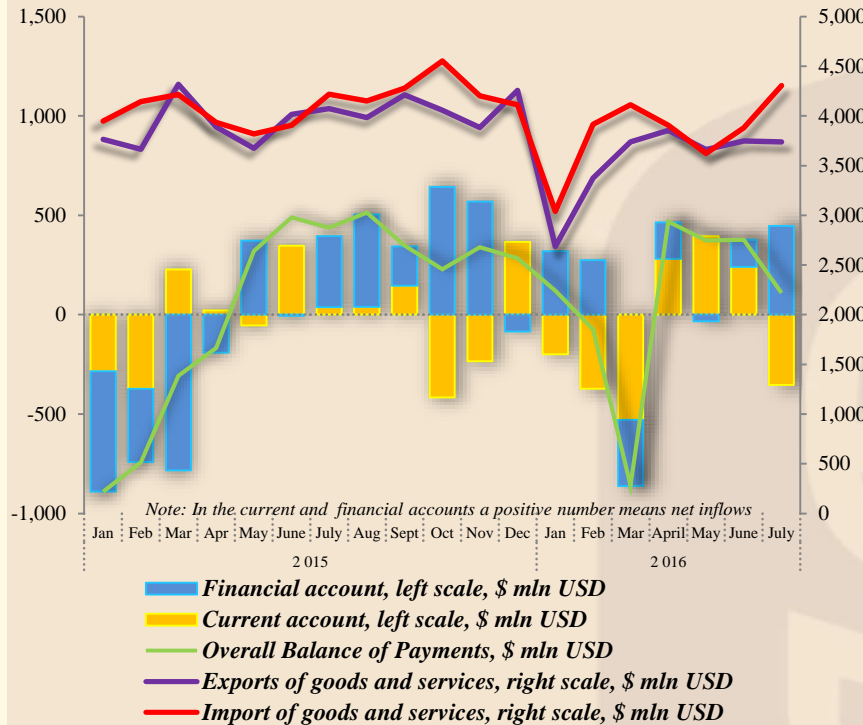
Source: State Statistical Service of Ukraine, The Bleyzer Foundation

UAH per 1 USD



- Consumer inflation has continued to decelerate, with inflation lowering to from 40.3% yoy in January 2016 to 7.9% yoy at the end of July.
- This CPI decline was mainly the result of increased supplies of food products, despite increases in gas and utility prices.
- In 2016, inflation would be 12%.
- The UAH/USD exchange rate saw significant volatility in August, which was related to worsening of the military situation in Donbas.
- If the military situation calms down, the FX rate should be around 27 UAH/USD by year-end and 28 UAH/USD by end of 2017.

Balance of Payments



- In January-July 2016 the overall balance of payments showed a surplus of USD 516 mn, increasing international reserves to USD 14.3 bn.
- This H1 BOP surplus was caused by a surplus in the financial account of USD 994 mn (thanks to USD 2.3 bn in FDI mainly for banks), and despite a deficit in the current account of USD 538 mn.
- The H1 deficit in the current account was caused by a large reduction in exports, (11.6% yoy) principally to Russia.

- Asia and Europe have become the largest buyers of Ukrainian products with shares of 34.5% and 34.1% of the total. Russia now represents 8.8% of exports.
- The IMF approved the disbursement of the USD 1.0 bn on September 14th. Ukraine will be able to secure an additional USD 1.6 billion in financial aid from the USA and the EU.

Economic Reforms 1

Reforms Carried Out

1. Macroeconomic stability

- Fiscal budget under control
- Prudent monetary policies
- Moved to flexible FX rate regime
- Inflation down to 12% at year-end

2. Reform Taxation, Expend & Customs

- Number of taxes cut from 22 to 11
- Payroll taxes cut in half to 22%
- Naftogaz eliminated income losses
- New electronic public procurement
- Procurement of medicine outsourced
- Single portal on public funds use
- Single retail price for natural gas

3. Eradicate Corruption

- New Prosecutor General appointed
- Three anti-corruption bodies in place
- New electronic income declaration
- Legal procedures for 150 officials

Pending Reforms

1. Macroeconomic stability

- Move NBU policy to inflation targeting

2. Reform Taxation, Expend & Customs

- Overall tax burden is still high
- Cumbersome Tax adm & VAT refunds
- Most subsidies are not monetized yet
- Tax privileges are not fully eliminated
- Electronic procurement still limited
- Electronic incm declarations sabotaged
- Pension system reform did not start
- Customs Adm remained unreformed

3. Eradicate Corruption

- Reform of Prosecution not initiated
- Anti corruption bodies are still weak
- Delays in setting Anti-Corruption Courts
- None top level official convicted.
- Privatization of state firms not happened

Economic Reforms 2

Reforms Carried Out

4. Legal and Judiciary Reform

- Constitution adjusted to permit judiciary reform
- Lustration law approved
- New police established

5. Improve public administration

- The size of government reduced
- “One-window” public administration
- Started fiscal decentralization with local revenues about 20% of the total

6. Develop the financial sector

- Banking system stabilized with closure of 80 weak banks
- Banking supervision improved with stress tests and re-capitalizations.
- Banks opened information about their final beneficiaries and owners.

Pending Reforms

4. Legal and Judiciary Reform

- No re-evaluation & dismissal of judges, prosecutors and other legal officials.
- Number of court abuses is still large
- Blanket immunities are not removed
- Commercial-Civil Codes unreformed.
- Business legal environment unreformed
- Number of raiding cases has increased.
- Shortage of qualified new police.

5. Improve public administration

- Government remains ineffective
- Functional reviews not conducted.
- Fiscal decentralization is slow/limited

6. Develop the financial sector

- Poor availability of financial resources.
- Independence of NBU is no finalized.
- Non-banking sector remains modest

Economic Reforms 3

Reforms Carried Out

7. Deregulate business activities

- Moratorium for business inspections.
- Some controlling agencies were eliminated (i.e., veterinary, sanitary)
- Open state registries and databases
- Management of state firms improved and cut income losses by 85%

8. Reform International trade/capital

- FTA with EU
- New FTA with Canada, Israel, Turkey
- Foreign debt was restructured

9. Reduce Political Risks

- No conflict between President-PM both with pro-EU orientation.
- TV channels/radio list owners.
- Actively engaged the US/EU to contain Russian aggression
- Strengthen local military forces

Pending Reforms

7. Deregulate business activities

- “Regulatory guillotine” not employed.
- Antimonopoly Committee inefficient
- 3,500 state firms still not privatized
- Energy and railway transportation markets are highly monopolized.
- Silent approval procedure not approved
- Rada slow in adopting deregulation laws with 3 out of 50 draft laws passed

8. Reform International Trade/capital

- Cumbersome international capital transfers
- Restrictions to exports still exists
- Slow harmonization of foreign trade

9. Reduce Political Risks

- The ruling coalition in Rada is weak.
- No Social Stabilization Fund
- Further Russian aggression possible