

November 2016

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

Executive Summary:

- ❖ The last two meetings of the Foreign Ministers of Ukraine, Germany, France, and Russia in Minsk on November 29th and by Skype on December 7th did not advance the resolution of the military conflict in Donbas. Nevertheless, the intensity of daily attacks against the Ukrainian army by separatists has decreased to around 30 per day in November compared to an average of 50 per day in October.
- ❖ Ukraine's reform agenda continues to move forward although at a slow pace. In November, the main priorities of reform initiatives were concentrated in the area of deregulation and fighting corruption. In particular, on November 3rd, the Ukrainian Parliament adopted a series of progressive laws that annulled 367 various resolutions and acts. The most recent development in fighting corruption is concentrated on the implementation of the second stage of electronic income declaration, under which all government officials must declare their assets and incomes. The deadline for this stage is the end of 2016.
- ❖ Ukraine's GDP grew by 1.8% yoy in the third quarter of 2016. High frequency data shows that the economy continued to recover in October 2016. In fact, in October 2016 agriculture output increased by 12.4% yoy. The construction sector also performed well, with construction output increasing by 7.8% yoy in October. The transportation sector also grew during the month, but at a lower rate of 0.4% yoy. The industrial production output index increased by 0.8% yoy during the month and retail trade turnover increased by 0.9% yoy.
- ❖ Significant acceleration in growth of state budget revenues and simultaneous deceleration in growth of state budget expenditures led to a positive state budget balance of UAH 3.1 billion in October. Local budgets also were executed with a surplus. As a result, the deficit of the state budget from the beginning of the year declined to UAH 60.3 billion and the consolidated budget deficit declined to UAH 26.9 billion (1.3% of period GDP).
- ❖ In October, growth in consumer prices accelerated to 12.4% yoy, due principally to increases in administratively regulated prices and tariffs. In particular, the housing and utilities price index increased to 44.4% yoy, with the biggest price increases in heating tariffs (which grew by 82.1% yoy) and gas prices (which grew by 42% yoy).
- ❖ The UAH/USD exchange rate was mostly stable in November. We leave our forecast for the exchange rate unchanged at around 26.0 UAH/USD by the end of the year
- ❖ Thanks to a surplus in the financial account that covered the deficit in the current account, as of November 2016, the level of international reserves remained at USD 15.6 billion (about 3.9 months of future imports.)

<i>Main Macroeconomic Indicators</i>	2011	2012	2013	2014	2015	2016f	2017f
<i>GDP, USD billion</i>	163	173	180	130	98	95	100
<i>Real GDP Growth, % yoy</i>	5.5	0.2	0.0	-6.6	-9.9	1.5	3.0
<i>Fiscal Balance (incl. Naftogaz & Pension Fund), % of GDP</i>	-4.3	-5.5	-6.5	-11.7	-8.0	-4.0	-3.0
<i>Public Debt, External and Domestic, % of GDP</i>	36.4	36.6	40.4	69.4	79.4	84.4	82.0
<i>Consumer Inflation, eop, % yoy</i>	4.6	-0.2	0.5	24.9	43.3	12.0	10.0
<i>Hryvnia Exchange Rate per USD, eop</i>	8.0	8.1	8.2	15.8	24.0	27.0	28.0
<i>Current Account Balance, % of GDP</i>	-6.3	-8.3	-9.0	-4.1	0	-2.0	-2.0
<i>FDI, Net Annual Inflow, USD billion</i>	7.0	7.2	4.1	0.3	2.3	3.0	3.0
<i>International Reserves, USD billion</i>	31.8	24.5	20.4	7.5	13.3	17.0	20.0
<i>Public External Debt, USD billion</i>	33.3	32.1	31.7	34.9	47.0	55.0	60.0
<i>Private External Debt, USD billion</i>	84.6	92.0	99.2	82.0	70.0	65.0	62.0

November 2016

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

Political and Reform Developments

The last two meetings of the Foreign Ministers of Ukraine, Germany, France, and Russia in Minsk on November 29th and by Skype on December 7th did not advance the resolution of the military conflict in Donbas. Nevertheless, the intensity of daily attacks against the Ukrainian army from separatists has decreased to around 30 per day in November compared to an average of 50 per day in October. The conflict has already destroyed the major part of the regional economy. It is estimated that GDP in the areas under separatist control is only about 30% to 40% of pre-conflict GDP, with economic activities going on mainly in agriculture. Humanitarian problems (i.e., water and food supply, heating of houses, medical care, etc.) are unresolved. Around 2 million citizens were forced to leave the conflict zone, with about 2.5 million people still remaining in the area. On a positive note, all parties agreed to develop a road map with concrete steps to initiate the release of Donbas hostages.

Ukraine's reform agenda continues to move forward although at a slow pace. In November, the main priorities of the reform initiatives were concentrated in the area of deregulation and fighting corruption. In particular, on November 3rd, the Ukrainian Parliament adopted a series of progressive laws that annulled 367 various resolutions and acts. These regulations were considered “business unfriendly”. The decision was prepared and backed by representatives of businesses and experts. In addition, the Parliament imposed an embargo on any inspections until the end of 2017, which should positively affect businesses and stimulate economic growth in the country.

Even though on a daily basis the local press reports innumerable cases of corruption incurred by low and middle-level government officials, the lion's share of these cases have not been brought to the attention of the courts. The most recent development in fighting corruption is concentrated in the implementation of the second stage of electronic income declaration. In the first stage, income declarations were submitted only by top government officials. In the second stage, remaining government officials must declare their assets and incomes. The deadline for this stage is the end of 2016. This stage will be followed by investigations by the National Anticorruption Agency, which will check the information submitted by all government officials in both stages. The Agency expects to finalize its work before April 2017. If the investigations of the Agency discover violations, the cases will be transferred to the Anticorruption Court. However, the process of forming Anticorruption Courts is not yet finalized. The process is currently under scrutiny by Ukrainian civil society and the country's international partners.

The recent IMF mission left Ukraine on November 12th. In its final statement, the mission confirmed that the country has made significant progress in delivering the reform agenda. However, the IMF stated that authorities need more time to implement policies to ensure medium-term fiscal sustainability (including adoption of a 2017 budget consistent with program target), safeguard financial and banking sector stability, and tackle corruption, including judiciary and court system reform. It is not expected that any funds will be released during 2016.

In November, Fitch upgraded Ukraine from 'CCC' to 'B-'. The agency assigned a “stable” outlook for the country. The upgrade was based on progress in the overall macroeconomic conditions of the country. In particular, the agency emphasized a number of positive developments, including economic growth, deceleration of inflation, increased foreign exchange reserves, and a decrease in the budget deficit.

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

November 2016

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

Economic Growth

Ukrainian GDP grew by 1.8% yoy in the third quarter of 2016. Compared to the second quarter of 2016, the economy increased by 0.4% qoq.

High frequency data shows that the economy continued to recover in October 2016. In fact, agriculture output increased by 12.4% yoy in October 2016. The construction sector also performed well, with construction output increasing by 7.8% yoy in October. The transportation sector also grew during October, but at a lower rate of 0.4% yoy. The industrial production output index increased by 0.8% yoy during the month and retail trade turnover increased by 0.9% yoy.

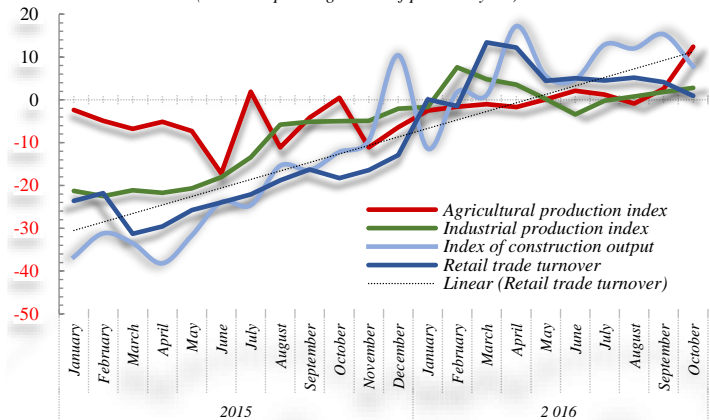
These results took place despite the negative effects of a surge in inflation in October, due to higher utility prices as discussed in the section on inflation below, and higher wages and salaries arrears (which climbed by 3.7% yoy during the month).

The data on industrial production by sector shows that the main slowdown in industry was caused by a 1.9% yoy decline in mining and quarrying activities. On the other hand, manufacturing activities increased by 1.3% yoy in October, while electricity, gas and steam generation increased by 3.7% yoy.

Within the manufacturing sector, food processing had the best performance in October 2016, with a growth rate of 3.2% yoy, followed by machine building, with growth of 2.5% yoy, and metallurgy with growth of 2.4% yoy. On the other hand, the poorest results were in the manufacturing of chemical products (-5.2% yoy) and coke and refined petroleum products (-8.2% yoy).

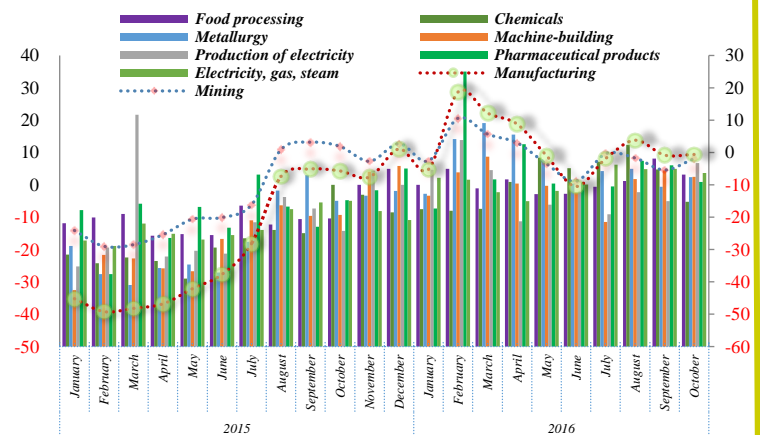
On a geographical basis, in October 2016, the regions with positive rates of growth in industrial output were as follows, ranked by performance: Kirovograd (18.2% yoy), Odessa (18.0% yoy), Zhytomyr (15.5% yoy), Lugansk (14.0% yoy), Mykolayiv (13.9% yoy), Khmelnytsky (11.0 yoy), Kharkiv (10.0% yoy), Ternopil (9.9% yoy), Chernivtsi (9.3% yoy), Volyn (8.2% yoy), Chernihiv (5.8% yoy), Kyiv (5.1% yoy), m. Kyiv (2.8% yoy); Kherson (1.8% yoy), and Ivano-Frankivsk (0.4% yoy). Negative rates of industrial output during October were experienced in the following oblasts: Vinnytsya (-0.1% yoy), Dnipropetrovsk (-0.2% yoy), Donetsk (-2.4% yoy), Rivne (-2.9% yoy), Cherkasy (-4.0% yoy), Lviv (-4.7% yoy), Transcarpathian (-4.8% yoy), Poltava (-6.2% yoy), Zaporizhia (-7.2% yoy), and Sums (-16.1% yoy).

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



Source: The Bleyzer Foundation

Industrial Production by Sectors, % yoy
(To corresponding month of previous year)



Source: State Statistics Committee. 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

November 2016

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

Fiscal Policy

Significant acceleration in growth of state budget revenues and simultaneous deceleration in growth of state budget expenditures led to a positive state budget balance of UAH 3.1 billion in October. Local budgets were also executed with a surplus of UAH 1.7 billion. As a result, the deficit of the state budget from the beginning of the year declined to UAH 60.3 billion and the consolidated budget deficit declined to UAH 26.9 billion (1.3% of period GDP).

State budget revenues returned to growth in October. The 29.9% yoy increase was due to the expansion of receipts from both tax and nontax revenues. Growth of tax revenues accelerated to 20.2% yoy thanks to good performance of agriculture and growth in VAT receipts.

In particular, the VAT payments of agricultural producers almost doubled compared to the previous month. At the same time, reimbursements of VAT payments were lower compared to September. Growth of non-tax revenues of 67% yoy was caused by the first transfer of profits from the NBU in the amount of UAH 10 billion.

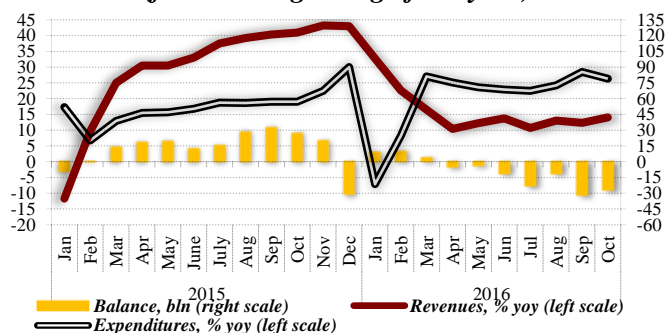
State budget expenditures saw deceleration in growth to 7.7% yoy in October. This deceleration took place in almost all major expenditure categories, including expenditures on goods and services, subsidies, transfers to enterprises, and capital expenditures.

Monetary Policy

Inflation. In October, growth in consumer prices accelerated in both monthly and year-over-year terms, due to non-core inflation. Core inflation remained flat compared to the previous month. The major reason for the 4.5 percentage point acceleration in total inflation to 12.4% yoy was the increase in administratively regulated prices and tariffs. In particular, the housing and utilities price index increased to 44.4% yoy from 15.8% yoy observed in the previous month. The most significant contribution to this price increase was heating tariffs (which grew by 82.1% yoy) and gas prices (which grew by 42% yoy). Other groups of goods and services observing significant acceleration in price growth were alcoholic beverages and tobacco goods, transport, foods and nonalcoholic beverages, and hotels and restaurants. At the same time, a notable deceleration of price growth was reported for wearing apparel and footwear, and for communications. Other groups of goods and services reported little change or remained flat.

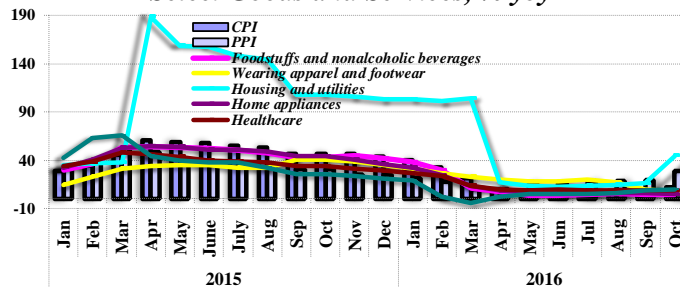
Despite significant acceleration, consumer inflation still remained within forecasted levels in October. Taking this into account and development in core inflation, we still expect consumer inflation to be around 12% yoy in 2016.

**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

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

November 2016

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

Banking Sector.

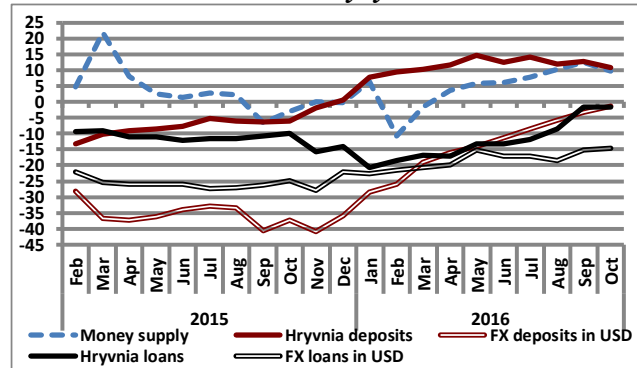
National currency deposits by the corporate and household sectors grew by 11.7% yoy in October, a slight decelerating from the growth in September. Although still declining, the situation with foreign currency deposits denominated in USD improved in October as their decline decelerated from 3.3% yoy to 1.2% yoy. Growth of corporate foreign currency deposits denominated in USD almost doubled to 13.0% yoy, while growth of household foreign currency deposits denominated in USD remained negative, but the decline decelerated by 0.5 percentage points to 6.4% yoy.

Regarding bank credits, thanks to improvements in the economy and the decline in interest rates, national currency loans increased in October. However, this growth was insufficient to bring the growth of these credits to positive terrain, with their year-over-year growth remaining almost unchanged at -1.6% yoy. Corporate loans continued to grow but at a slightly decelerated rate of 0.9% yoy. At the same time, the decline in household loans insignificantly decelerated to 6.1% yoy. The situation with foreign currency loans slightly improved in October, with their decline decelerating to 14.5% yoy. As in the previous month, corporate sector loans declined at a lower pace compared to loans of the household sector (13.3% yoy against 19.6% yoy).

Cash balances at the correspondent accounts of commercial banks in the NBU decreased at the end of October, which caused a minor monthly decline in the monetary base, which slowed down its year-over-year growth by 1.0 percentage points to 11.6%. Money supply remained unchanged in monthly terms as cash balances outside the banking system and deposits were flat. Thus, the year-over-year growth of money supply decelerated to 9.8%.

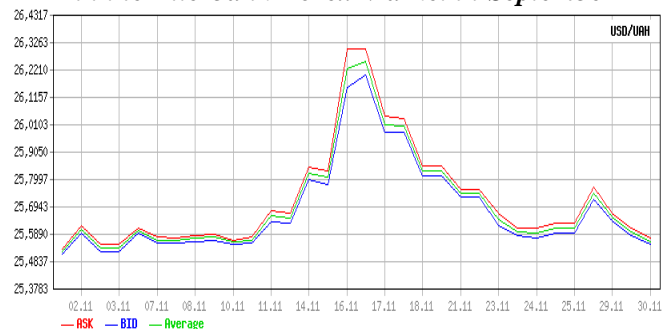
Hryvnia Exchange Rate. The UAH/USD exchange rate was mostly stable in November. However, there was a short period of depreciation triggered by lower FX supply due to Veterans Day in the US (when the dollar market was closed) and supported by increased banking sector liquidity. Depreciatory pressure on the exchange rate continued for a couple of days because of increased political tensions on the eve of Revolution of Dignity commemorations, forcing some forex market players to purchase the dollar at higher prices. Starting on November 16th, however, the exchange rate began to appreciate again and by the end of the month had returned to the level observed at the beginning of the month. Hence, we leave our forecast for the exchange rate unchanged at around 26.00 UAH/USD through the end of the year.

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



Source: The NBU, The Bleyzer Foundation

Dynamics of UAH/USD Exchange Rate Quotations in the Interbank Forex Market in September



Source: Ukrdealing, 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

November 2016

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

International Trade and Capital

In October 2016, the Ukrainian current account of the balance of payments had a deficit of USD 234 million, significantly lower than the deficit of USD 891 million incurred in September 2016. The cumulative deficit from January to October 2016 reached USD 2,539 million, which is about 3.1% of period GDP. The October current account deficit was covered by net financial account inflows of USD 311 million, principally in the form of foreign loans to banks (USD 219 million). International reserves remained flat at about USD 15.6 billion by the beginning of November.

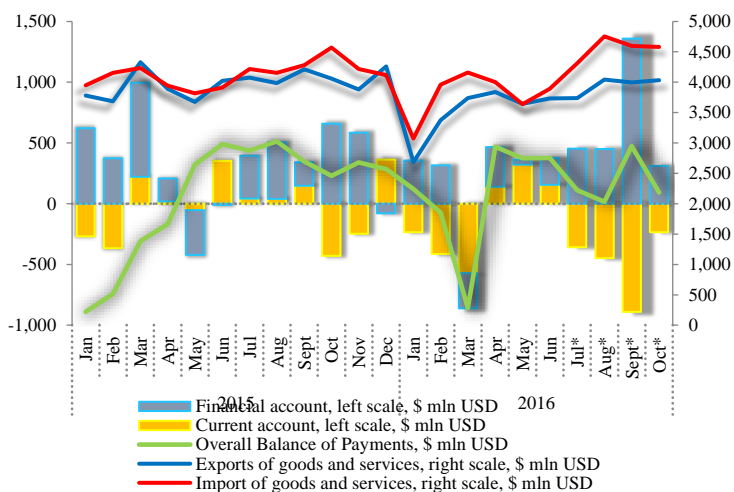
The improvement in the current account in October was due principally to lower interest rate payments, with the Primary Income balance improving from a deficit of USD 525 million in September to a surplus of USD 64 million in October. Trade in goods and services also improved. During the month of October, exports of goods and services increased by 0.9% mom, to USD 4,034 million, whereas imports of goods and services declined by 0.5% mom to USD 4,580 million.

On a year-over-year basis, during October 2016, the major improvements in merchandise exports were in ferrous and nonferrous metals (5.8 % yoy), followed by agricultural products (2.9 % yoy), and industrial goods (0.3 % yoy). On the other hand, a large reduction in Ukrainian exports occurred in chemicals (-26.1% yoy), machinery and equipment (-11.5 % yoy), and timber and wood products (-3.8 % yoy). At the same time, the major reductions in Ukrainian merchandise imports in October took place in mineral products including energy (-29.3 % yoy), and informal trade (-7.0 % yoy). Imports increased in chemicals (1.6 % yoy), industrial goods (4.7 % yoy), timber and wood products (11.8 % yoy), agricultural products (16.6 % yoy), ferrous and nonferrous metals (22.1 % yoy), and machinery and equipment (34.6 % yoy).

Regarding the regional destination of exports, in January–October 2016, exports to Russia declined by 30.1% yoy, and now account for 9.2 of total exports, compared to 12.0% a year ago. On the other hand, Ukraine's exports to Europe increased by 1.6% yoy, and now represent 32.7% of total exports, compared to 29.4%, in January–October 2015. Asia's share in total exports declined by 9.7% yoy (principally to Asia's CIS countries following Russian pressures) and now amount to 34.8% of the total.

The NBU predicts that in 2017, the deficit of the current account of Ukraine's balance of payments will amount to USD 2.9 billion. The country will have to repay USD 2.5 billion of foreign debt, and USD 1.0 billion of the stand-by loan received from the IMF. On this basis, the total foreign exchange requirements in 2017 would be USD 6.4 billion. The NBU's basic forecast envisions receiving four tranches of \$5.4 billion from the IMF in 2017. Additional financing would be forthcoming from the EU, the World Bank, EBRD, and expected Eurobond issues.

Ukraine's External Balance of Payments, mln USD



Source: NBU, 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