Executive Summary:

- The recent political crisis in Ukraine ended with a reshaping of the ruling coalition and the appointment of a new Cabinet of Ministers. The new parliamentary coalition includes 207 members from President Poroshenko’s Block and the People’s Front, as well as 20 independent parliamentarians. The total coalition of 227 parliamentarians is just above the required 226 majority.

- Newly appointed Prime Minister Volodymir Groisman announced that his immediate reform agenda includes restoration of cooperation with international financial institutions including the IMF. He also stated that the fight against corruption remains a priority for the government. Other important items in the PM’s agenda include carrying out judicial reform, tax system reform, business deregulation and public administration reform. In addition, the government promised to ensure open and transparent privatization of state enterprises.

- Preliminary estimates by the State Statistics Committee indicate that year-over-year growth of GDP in the first quarter of 2016 was positive, though by a small percentage of 0.1%. The latest high-frequency data from the State Statistics Committee also shows that Ukraine’s macroeconomic situation is continuing to improve. In March 2016, industrial production increased by 4.8% compared to March 2015.

- In March 2016, a deceleration in the growth of revenues and an acceleration in growth of expenditures, both at central and local levels, led to a 50% shrinking in the consolidated fiscal budget surplus. Nevertheless, the overall consolidated budget balance for Q1 remained positive at UAH 3.9 but it more than halved in one month.

- Consumer inflation has continued to decelerate at a high pace in March thanks to increased supply of whole foods.

- Both bank deposits and loans posted rather sluggish performance in March, but expectations of banking sector dynamics over the next 12 months significantly improved.

- The UAH/USD exchange rate appreciated for most of April. Increased supply of dollars on the side of exporters and agribusinesses was the main reason, but the trend was also supported by stabilization of the political situation in the second half of the month.

- In April, the NBU held 13 forex auctions to mitigate appreciatory fluctuations of the exchange rate and replenish international reserves purchasing USD 676 million in the interbank forex market.

- In March 2016, the current account deficit increased to USD 448 million from USD 208 million in February. This deterioration was due to a significant increase in the deficit on primary income (principally interest payments) from a surplus of USD 38 million in February to a deficit of USD 425 million in March. But this deterioration on primary income was partly compensated for by improvements in the merchandise trade balance, caused by increased exports and lower energy imports.

- In January-March 2016, goods exports to Russia decreased by 39.5% yoy and now represent 7.5% of total exports, compared to 10% in January-March 2015. Exports to Asia decreased by 21.2% yoy, representing 35% of total Ukrainian exports. Exports to Europe declined by 2.9% yoy and now account for 37% of exports.

- There is currently an IMF mission in Kyiv, discussing with the government the possibility of a new disbursement of USD 1.7 billion. The government has taken a key measure required by the IMF, which is the increase in gas prices for the population. But there are a number of other pending conditions for disbursements, including monetary policies, banking rehabilitation, anti-corruption policy, pension reform, judicial reform, the reform of tax administration, reforms of state-owned enterprises, and privatization. The result of the review should be available by the end of the month. If the result is positive, in addition to the UAD 1.7 billion from the IMF, Ukraine will be able to secure an additional USD 2.3 billion in financial aid from other multilateral and bilateral institutions.
Main Macroeconomic Indicators

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<th>2011</th>
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<td>GDP, USD billion</td>
<td>163</td>
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<td>Real GDP Growth, % yoy</td>
<td>5.5</td>
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<td>Fiscal Balance (incl. Naftogaz &amp; Pension Fund), % of GDP</td>
<td>-4.3</td>
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<td>-6.5</td>
<td>-11.7</td>
<td>-3.5</td>
<td>-4.0</td>
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<td>Public Debt, External and Domestic, % of GDP</td>
<td>36.4</td>
<td>36.7</td>
<td>39.9</td>
<td>70.3</td>
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<td>Consumer Inflation, eop, % yoy</td>
<td>4.6</td>
<td>-0.2</td>
<td>0.5</td>
<td>24.9</td>
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<td>Hryvnia Exchange Rate per USD, eop</td>
<td>8.0</td>
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<td>15.8</td>
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<td>Current Account Balance, % of GDP</td>
<td>-6.3</td>
<td>-8.2</td>
<td>-9.2</td>
<td>-3.6</td>
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<td>FDI, Net Annual Inflow, USD billion</td>
<td>7.0</td>
<td>7.2</td>
<td>4.1</td>
<td>0.3</td>
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<td>International Reserves, USD billion</td>
<td>31.8</td>
<td>24.6</td>
<td>20.4</td>
<td>7.5</td>
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<td>Public External Debt, USD billion</td>
<td>33.3</td>
<td>32.1</td>
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<td>Private External Debt, USD billion</td>
<td>84.6</td>
<td>92.0</td>
<td>99.2</td>
<td>82.0</td>
<td>70.0</td>
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Political and Reform Developments

The recent political crisis in Ukraine ended with a reshaping of the ruling coalition and the appointment of a new Cabinet of Ministers. The new parliamentary coalition includes 207 members from President Poroshenko’s Block and the People’s Front, as well as 20 independent parliamentarians. The total coalition of 227 parliamentarians is just above the required 226 majority. This fragile majority could become a significant risk factor in the future when the support of the majority will be required for some controversial issues. On the other hand, it ensures some degree of checks-and-balances. Nevertheless, the resolution of the political crisis will permit the government to turn its attention to the implementation of reforms.

Newly appointed Prime Minister Volodymir Groisman announced that his immediate reform agenda includes restoration of cooperation with international financial institutions including the IMF. For this, his Cabinet is ready to undertake even unpopular measures. Indeed, these measures, including a gas tariff hike for the population, were already announced and became effective on May 1st, 2016. In April, the corresponding decree of the Cabinet introduced one unified market price for gas for all groups of consumers. The new unified pricing on the energy market should also avoid a number of abuses, which were due to re-selling gas by the state monopoly NAK Naftogas. It is also expected that this state-owned company would be de-monopolized in the near future to allow competition in the energy market. In addition, all preferential treatments which NAK Naftogas currently enjoys would be removed (i.e., VAT exemptions, access to forex market, state financing etc.).

In his first statements, the Prime Minister reconfirmed that the fight against corruption remains a priority for the government. Other important items in the PM’s agenda include carrying out judicial reform, tax system reform, business deregulation and public administration reform. In addition, the government promised to ensure open and transparent privatization of state enterprises. The Cabinet also pointed out that the privatizations would be carried out in a way that would ensure a high level of competition and maximize budget revenues.

On the military side, troops of the Russian-backed terrorists in the Eastern part of Ukraine continued a number of provocations against the Ukrainian army. These facts were mentioned in statements by the OSCE monitoring mission. Moreover, the OSCE continued to observe non-withdrawal of heavy weapons in the regions as was required under the Minsk Agreement. In addition, rebels have constantly shelled Ukrainian troops with small arms and grenade launchers.
Economic Growth

Preliminary estimates by the State Statistics Committee indicate that year-over-year growth of GDP in the first quarter of 2016 was positive, though by a small percentage of 0.1%. The latest high-frequency data from the State Statistics Committee also shows that Ukraine’s macroeconomic situation is continuing to improve. In March 2016, industrial production increased by 4.8% compared to March 2015. Following a high growth rate of industrial output in February, the month of March 2016 was the second consecutive month with positive industrial growth on a year-over-year basis since early 2012. Industrial growth in March 2016 was supported by good performance of manufacturing output, which expanded by 6.5% yoy, and by mining and quarrying, which grew by 5.7% yoy. But growth was restrained by the poor performance of electricity, gas & steam production which declined by -2.3% yoy.

According to State Statistics Committee data, in March 2016, major expansions in manufacturing production took place in the production of computer, electronic & optic products, which expanded by 59.7% yoy; metallurgy, which grew by 19.1% yoy; motor vehicles, which expanded by 13.5% yoy; furniture, which increased by 16.5% yoy; and machine-building, which rose by 8.7% yoy. However, the following subsectors continued to show declines in industrial output in March 2016: chemicals production declined by -7.4% yoy, wood products declined by -2.1% yoy, and food processing dropped by -1.2% yoy.

Regarding industrial production by regions, the major expansions in March 2016 took place in Lugansk (with 174% yoy raise); Ternopil (17.6% yoy); Chernihiv (14.6% yoy); Donetsk (10.1% yoy), Transcarpathia (9.9% yoy); Kherson (9.9% yoy); Kirovograd (9.5% yoy); Kharkiv (9.2% yoy); Lviv (8.2% yoy); Odessa (7.5% yoy) and Kyiv (5.7% yoy). On the other hand, the regions with the largest declines were Vinnytsia...
(with an output decline of -12.8% yoy), Volyn (-8.6% yoy), Ivano-Frankivsk (-8.2% yoy), and Mykolaiv (-6.6% yoy)

During March, other economic activities also showed recovery. In particular, in March 2016 retail trade expanded at a high rate of 13.4% yoy. This recovery was due in part to a deceleration in the decline of real wages, lower wage arrears, and improved employment figures. Construction activities showed some recovery, growing by 1.1% yoy in March. Similarly, cargo transportation expanded by 4.1% yoy in January-March 2016.

For the entire year 2016, we maintain our forecast of GDP growth at about 2%.

**Fiscal Policy**

In March 2016, a deceleration in the growth of revenues and an acceleration in growth of expenditures, both at central and local levels, led to a 50% shrinking in the consolidated fiscal budget surplus. At the central level, the deficit of the state budget expanded to UAH 8.2 billion during the month. As a result, the state budget was executed with the cumulative deficit of UAH 10.6 billion in Q1 2016. At the same time, the surplus of local budgets shrank to only UAH 2.2 billion, marginally increasing the cumulative budget surplus for the first quarter to UAH 14.4 billion. Therefore, the overall consolidated budget balance for Q1 remained positive at UAH 3.9 but it more than halved in one month.

A deceleration in the growth of revenues in March compared with last year was expected due to statistical base effects, as the impact of depreciation and inflation on budget revenues was at its highest level in March 2015. In addition, in March 2015 the state budget received high receipts from additional import duties and from receipts from the sale of 3G communication licenses. In March 2016, the growth of receipts from domestic taxes on goods and services decelerated from 35.7% yoy observed in February to 29.7% yoy. This reduction took place despite increases in March of excise tax rates, improvements in excise tax administration, and additional inflows of the VAT thanks to some activation of retail trade and imports. Growth of receipts from personal income taxes remained almost unchanged at 33.6% yoy, while the decline in receipts from corporate profit taxes further decelerated (from 55% yoy in February to 2.5% yoy in March) thanks to both changes in procedures and improvement in the financial stance of state enterprises.
Revenues of the local budget also decelerated in March, but much less than at the central level. Furthermore, thanks to still high growth of both tax and nontax revenues of local budgets, growth of consolidated budget revenues saw only a small change compared to that observed as of the end of February. The consolidated budget revenues grew by 16.5% yoy in Q1, which is 3.9 percentage points slower than in January-February.

Regarding budget expenditures, in March 2016, they grew at an accelerated rate at both central and local levels. However, acceleration of expenditure growth was more significant at the local level, with higher expenditures in all items. State budget expenditures grew by 28.9% yoy in Q1 2016, which is an almost 6-fold acceleration from 5.0% yoy observed in January-February period. Expenditures on general government functions and on social security remained the two major expenditures items. At the same time, the fastest growth rates among the state budget expenditures in Q1 were on defense expenditures (which grew by 54.8% yoy), on expenditures in general government functions (which expanded by almost 53.0% yoy), and on social security expenditures (which increased by 26.9% yoy). Expenditure on economic activity was the only expenditure item observing declines in Q1. From the point of view of economic expenditure classification, capital expenditures grew much faster than current expenditures. Actually, dynamics of capital expenditures reversed the trend from a 21.6% yoy decline in January-February to a 96.6% yoy growth in January-March. Current expenditures saw acceleration of growth from 5.2% yoy to 28.6% yoy mostly due to a jump in expenditures on state and guaranteed debt servicing. Growth of local budget expenditures accelerated mostly on the back of increased social security, education expenditures, and spending on economic activity and utilities. Overall, the consolidated budget revenues grew at 27.0% yoy in Q1.

**Monetary Policy**

**Inflation.** Although in March consumer prices grew on a month-on-month basis, year-over-year consumer inflation continued to decelerate at a high pace, declining from 32.7% yoy in February to 20.9% yoy in March. The major reason for this deceleration was an increase in the local supply of whole foods due to lower export opportunities caused by trade restrictions imposed by Russia and by expanded imports of fruits and vegetables. In particular, prices of foods and nonalcoholic beverages declined by 0.7% mom leading to deceleration in over-year growth of prices from 29.7% yoy to just 11.4% yoy. Most of the other major groups of goods and services also observed deceleration of inflation in year-over-year terms. In particular, on a year-over-year basis, the growth of prices of home appliances and healthcare halved from 24.3% and 23.3% to 13.4% and 13.5%, respectively. Similar dynamics were reported in the recreation and culture sector. Prices of transport services posted negative year-over-year growth of 4.2%. The only sector observing growth of prices year-on-year was utilities. A 25.2% increase of the electricity tariff led to a growth of utilities prices which accelerated the year-on-year growth by 3.5 percentage points to 104.3%. Further deceleration of consumer inflation is expected during 2016 due to the fact that domestic demand remains low, inflationary expectations have stabilized, the impact of the exchange rate fluctuations on prices is negative, and comparative statistical base is high. Therefore, we leave our forecast for consumer inflation intact for now at 12% yoy in 2016.

**Banking Sector.** During March, on a month-on-month basis, Hryvnia and USD bank deposits of corporate and household sectors moved in opposite directions. In particular, household national currency deposits increased...
(by 0.9% mom), while household foreign currency deposits denominated in USD posted a minor decline (0.5% mom). In contrast, corporate national currency deposits posted a decline (3.1% mom), while corporate foreign currency deposits denominated in USD increased (by 6.3% mom).

Regarding bank lending, after a one-month increase in credit activities in February, loans in national currency posted declines in both the corporate and household sectors (by 0.6% mom and 1.0% mom respectively). Foreign currency loans denominated in USD further declined in March with the rate of decline in household sector accelerating to 3.9% mom, while in the corporate sector the decline remained insignificant at 0.3% mom.

Despite the overall sluggish performance in terms of both attracting new deposits and provision of new loans, banks expect significant improvements over the next 12 months, according to the most recent survey on credit conditions held by the NBU among Ukrainian banks. In particular, 62% of banks expect an increase in lending to entities in the next 12 months. The share of banks that are optimistic about activation of retail credits increased from 33% to 44%. As for deposits, 70% of banks expect an increase in corporate sector deposits over the next 12 months, while the share of banks expecting the same for household deposits is 61%. Improvement in bank expectations is the first sign of renewal of trust in the banking sector by population and business.

A decrease in the amount of cash in banks together with lower deposits led to a further monthly decline in money supply by 0.8%. At the same time, diminishing effects from revaluation led to a deceleration in the decrease of the money supply in year-over-year terms to 1.7%.

**Hryvnia Exchange Rate.** During April, the UAH/USD exchange rate gradually appreciated from around 26.3 UAH/USD to around 25.2 UAH/USD. There were several reasons for this trend. First of all, agribusinesses increased their supply of dollars to the interbank forex market because of the spring sowing campaign. Second, world market infrastructure and price developments were favorable for some of Ukraine’s traditional exports, like metallurgical products and foodstuffs. Third, the political situation in the country stabilized after the appointment of the new COM in mid-April. This led to the signing of an agreement with the USA on provision of the third tranche of US government loan guarantees worth USD 1 billion further strengthening the Hryvnia. Finally, the NBU regularly held its forex auctions to mitigate the exchange rate fluctuations and replenish international reserves. Overall, the regulator held 13 auctions and purchased USD 676 million in April.

The NBU continued its work on liberalization of foreign exchange market regulations. On April 28th, the regulator allowed banks not to sell foreign currency provided as a loan to pay for imported goods, in case the borrower. The NBU is also preparing to allow purchasing and transfer of foreign currency abroad for the purposes of dividend repatriation. In particular, the regulator obliged banks to collect information concerning entities or persons wanting to repatriate dividends abroad, banks authorized by clients to repatriate dividends (each client can choose only one bank for these purposes), the time period for
which dividends are paid, and the total amount of dividends for repatriation. Based on the collected data, the NBU will develop a schedule and procedure for dividends repatriation. Repatriation will be held in several stages over a time period to be determined.

For now we are leaving our forecast for the exchange rate at the end of 2016 unchanged at about 25 UAH/USD.

**International Trade and Capital**

In March 2016, the current account deficit increased to USD 448 million from USD 208 million in February. This deterioration was due to a significant increase in the deficit on primary income (principally interest payments) from a surplus of USD 38 million in February to a deficit of USD 425 million in March. But this deterioration on primary income was partly compensated for by improvements in the merchandise trade balance, caused by increased exports and lower energy imports. In fact, merchandise exports in March reached USD 2,755 million, an increase of 12.5% mom over February, while merchandise imports increased by only 3.4% mom. Between January and April 2016, Ukraine managed to reduce imports of natural gas by 2.5 times, compared to the same period in 2015.

On a year-over-year basis, merchandise exports in March declined by -15.9% yoy. In that month, the major export declines took place in chemical products (-41.9% yoy), (in February -29.1%); ferrous and non-ferrous metals (-33.0% yoy), minerals (-33.8% yoy), and machinery and equipment (-15.5% yoy). On the other hand, exports of agricultural products increased by 7.4% yoy in March. Geographically, in January-March 2016 goods exports to Russia decreased by 39.5% yoy and now represent 7.5% of total exports, compared to 10% in January-March 2015. Exports to Asia decreased by 21.2% yoy, representing 35% of total Ukrainian exports. Exports to Europe declined by 2.9% yoy and now account for 37% of exports.
On the import side, on a year-over-year basis, merchandise imports declined by -6.2%, with the largest decline in energy/mineral products (-55.5% yoy). All other categories of imports showed increases: machinery and equipment (38.8% yoy), agricultural products (24.4% yoy), chemicals (21.8% yoy), and ferrous and non-ferrous metals (16.9% yoy). Europe has now become the largest supplier of products to Ukraine, accounting for 41% of imports. Imports from Russia have declined to 11% on Ukrainian imports.

Similar to the current account, the financial account was also negative, with net outflows of USD 415 million. This outflow was due principally by the first payment of coupon in the amount of USD 473 million on new dollar-denominated government domestic bonds issued in November 2015.

As a result of deficits in the current and financial accounts, the overall balance of payments deficit increased to USD 859 million. This led to a reduction of international reserves to USD 12.7 billion (or 3.3 months of future imports) as of the end of March 2016.

As noted earlier, the IMF-Ukraine four-year Extended Fund Facility program of USD 17.5 billion originally foresaw quarterly revisions of the program, with four tranches expected to be disbursed in 2015, and another four in 2016. However, so far, the country has received only the first tranche of USD 5 billion in March 2015, and the second one of USD 1.7 billion in August 2015. There is currently an IMF mission in Kyiv, discussing with the government the possibility of a new disbursement of USD 1.7 billion. The government has taken a key measure required by the IMF, which is the increase in gas prices for the population. But there are a number of other pending conditions for disbursements, including monetary policies, banking rehabilitation, anti-corruption policy, pension reform, judicial reform, the reform of tax administration, reforms of state-owned enterprises, and privatization. The result of the review should be available by the end of the month. If the result is positive, in addition to the UAH 1.7 billion from the IMF, Ukraine will be able to secure an additional USD 2.3 billion in financial aid from other multilateral and bilateral institutions.