Monthly Economic Monitor Ukraine

No.10 (192), October 2016

EXECUTIVE SUMMARY

HIGHLIGHT: BUDGET 2017

Politics: The IMF Executive Board completed the second review of Ukraine's economic program supported by the arrangement under the Extended Fund Facility and approved disbursement of the USD 1 bn loan.

Real sector: Real GDP growth accelerated from 0.1% yoy in the first quarter 1.4% yoy in the second quarter of 2016 due to increase in domestic demand.

Energy sector: On September 22, the Verkhovna Rada approved the Law on the National Energy and Utilities Regulatory Commission, which was required by experts and international donors.

Agriculture: Gross agricultural production in August decreased by 0.9% yoy due to decline in dairy and egg production.

External sector: Current account in August was in deficit at USD 0.4 bn as compared to balanced current account in August 2015 due to higher merchandise trade deficit.

Fiscal policy: Consolidated fiscal revenues in September increased by 6.4% yoy. The NBU was still not able to transfer the profits to the budget due to prolonged delay in forming NBU Council.

Social policy: Disposable income in the second half of 2016 increased by 14.3% yoy in nominal terms due to higher revenues from all sources.

Labour market: Labour market situation stabilised, which is reflected in rather stable unemployment rate and higher wages.

Monetary policy: Consumer inflation slowed to 7.9% yoy in September from 8.4% yoy in August.

Exchange rate: The NBU helped reduce volatility on the foreign exchange market by selling USD 178 m.

State debt: The approval of the Second Review of the IMF Program enabled the Government to place U.S.-guaranteed bonds at the lowest interest rate.

Highlight of the month: Budget 2017

OPTIMISTIC VIEW ON THE BUDGET BUT WITH A DISCLAIMER FOR RISKS

by Oleksandra Betliy

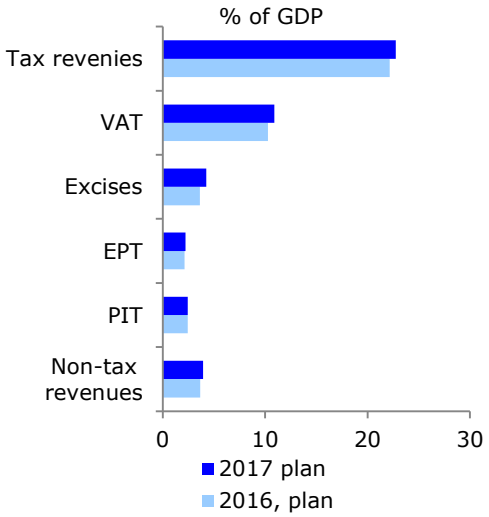
The Government submitted the Draft State Budget Law for 2017 to the Parliament on September 15, 2016, which is the deadline in the Budget Code. There are some grounds to expect the budget process will move smoothly and will be approved by the end of November. So far, the Ministry of Finance actively engaged in discussions on fiscal parameters, while members of parliament as usual are trying to outdo each other in finding fault with some or all aspects of the proposed Budget.

Macroeconomic assumptions. The Draft Budget major parameters are based on macroeconomic forecast, which is realistic but on optimistic side. Budget is based on increase in nominal GDP by 14% and 3.0% real GDP growth. For comparison, according to revised IER's forecast GDP is expected to grow by 2.7% in real terms and by 13.3% in nominal terms. Therefore, there is a risk to fiscal revenues if Ukrainian economy underperforms in 2017.

Revenues. Central fiscal revenues are planned to increase by 16.1% to UAH 706 bn (from 2016 budget plan). This translates into 27.3% of GDP (based on official forecast) or 0.4 p.p. higher than in 2016. This reflects higher projection of tax revenues. In particular, VAT revenues are planned to increase primarily due to the elimination of special VAT scheme for agricultural companies. Additional VAT collections will be partially used to make VAT refunds more prompt and less complicated. Increase in excise rates and growth of consumption is expected to bring additional revenues from excises. Improved consolidated financial results of companies is expected to bring higher EPT revenues. At the same time, PIT revenues in relation to GDP are expected to remain at the level of 2016. Overall revenues from rent payments is expected to decline due to lower rent rates on oil and gas extraction.

Non-tax revenues is expected to somewhat increase due to higher planned revenues from state-owned enterprises. The transfer of the NBU profit to the budget is expected to decline in relation to GDP, (at UAH 41 bn in 2017 as compared to UAH 38 bn in 2016). Particular risk in executing non-tax revenues relates to the revenues from special confiscation (planned at UAH 10.5 bn). This year these revenues were not received to the budget due to imperfect legislation.

Central fiscal revenues



Source: State Budget Law for 2016, Draft State Budget law for 2017

Expenditures. Subsistence minimum and, thus, minimum pension and minimum wage will increase by 15.9% on average in 2017 and by 13.7% yoy in December, which means increase of social standards in real terms. Such increase in aimed at some recovery of purchasing power after sharp decline in 2014 and 2015. Wages in public sectors are promised to be increased by path higher than minimum wage increase.

The Government plans to increase spending more or less evenly on all major functions of the budget. Thus, the structure of the fiscal expenditures will not change substantially. In particular, lack of pension and social welfare reforms means that welfare spending will still dominate the budget. The Government did introduce a number of changes to expenditure side of the Budget but it is too early to judge if they contribute to efficiency of fiscal expenditures as it would depend on the implementation procedures that are to be approved later. For example, the Government proposed funding of coal mines restructuring but in the past there are few examples of successful mine closures. The stipends to students at tertiary education establishments will be confined to poor and the most successful students but the exact criteria of stipends provision are not defined yet.

Draft Budget has UAH 3.0 bn in direct state aid to small farmers. There is little previous experience of successful subsidies to small agricultural producers but there is a potential for more competition to large holdings in agriculture if small producers increase their production.

Significant step is proposed transfer of responsibility for payment of housing and utility costs of education and health facilities to own revenues of local budgets (previously this was a part of educational and medical subventions). This is supposed to create incentives for better energy efficiency at these facilities. The Government also plans to establish Energy Efficiency Fund and allocated for this purpose UAH 800 m. However, to make it a reality the Parliament has to first approve a Law on Electricity Market, which would open a possibility for the allocations of international donors to this Fund.

The efficiency of State Regional Development Fund will also depend on the criteria for allocations of funds to project financing. Currently, the Fund seem to lack quality applications.

Overall, the draft Budget for 2017 is rather realistic. However, there are risks related to lower than officially expected economic growth, populism of people deputies during voting for the Budget in the Parliament. Another risk relates to possible implementation gaps.

Monthly Economic Monitor Ukraine

Politics: Politics: IMF provides USD 1 bn loan to Ukraine

The IMF. The IMF Executive Board completed the second review of Ukraine's economic program supported by the arrangement under the Extended Fund Facility (EFF) and approved disbursement of the USD 1 bn loan to Ukraine. It was the third tranche given to Ukraine under the EFF (initially planned to be provided in September 2015), which brought the total sum of disbursements under the arrangement to about USD 7.62 billion. The IMF Staff Report states that Ukraine has taken important policy measures since the last review, which include fiscal adjustment, completion of the debt operation with private bondholders, increase in gas and heating tariffs, and decisive steps to rehabilitate the banking system. However, the Report also notes that Ukraine's progress in tackling corruption, selling state-owned enterprises, and implementing pension reform has been slower due to 'significant political resistance'. The size of the tranches was decreased from 1.7 billion to 1 billion of US dollars. To receive next tranche of the loan (initially planned for November 2016), the Government has to continue reforms. The submission of the draft law on land turnover is likely to be the most challenging task for the Government especially taking into account continuation of the moratorium on the sale of agricultural land by 2018 (which was approved by the Parliament on October 6).

The war in Donbas. The ceasefire agreement that started on September 1 brought down the number of losses for Ukrainian army but the attacks by combined Russian-separatist forces did not stop. 12 service members of the Ukrainian Armed Forces were killed in the war and 71 service members were wounded. The Chief of the National Police in Donetsk oblast Vyacheslav Abroskin reported that 21 civilians were killed and 94 civilians were wounded in Donetsk oblast over the eight months of 2016 due to the military conflict. President's Humanitarian Envoy at the Minsk peace talks Iryna Gerashchenko said that during 2016, only 14 Ukrainian citizens were freed from combined Russian-separatist forces' captivity and only 3 persons were freed from Russian prisons. Meanwhile, President Poroshenko signed the decree on demobilization of soldiers who were mobilized in the sixth wave of ATO mobilization.

Judicial reform. The Verkhovna Rada of Ukraine used its last chance to dismiss judges one day before changes to Ukraine's Constitution took effect. The legislative body voted for dismissal of 29 judges, 19 of whom ruled against the participants of the Euromaidan protests in 2013 and 2014. It was a final opportunity for the Verkhovna Rada to dismiss these judges before the amendments to the Constitution on the judicial reform and a new law 'On the Judicial System and the Status of Judges' took effect. New legislation strips the President and the Parliament of the power to dismiss judges, limits the immunity of judges from prosecution, and increases control over their sources of income. The reform aims to increase independence of the judiciary from corruption and from the influence of politicians and oligarchs.

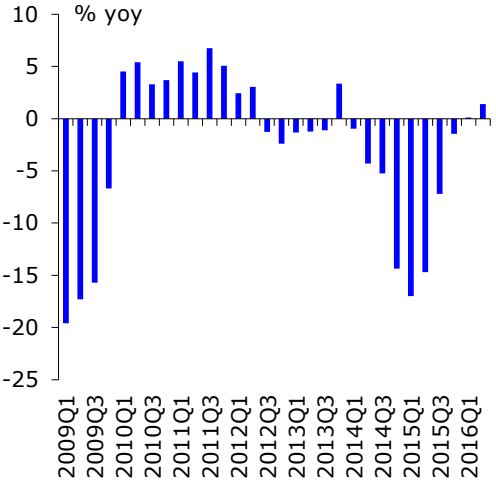
Crimea. In September, the *de facto* Supreme Court of the Russia-occupied Autonomous Republic of Crimea banned the activity of the Mejlis of the Crimean Tatar People calling it an extremist organization. This decision puts about 3,000 Crimean Tatars under the threat of imprisonment. The Mejlis is a governing body of Crimean Tatar people and acts on the basis of international law and laws of Ukraine. Also in September, Russian parliamentary elections took place in Crimea. A number of foreign countries, including Estonia, France, Germany, Lithuania, the UK, and the USA, did not recognize the legitimacy of the elections in Crimea. Ukraine did not recognize the newly elected seventh convocation of Russia's State Duma as legitimate.

Real sector: Increase in investments

GDP. Real GDP growth accelerated from 0.1% yoy in the first quarter 1.4% yoy in the second quarter of 2016. Growth was supported by increase in domestic demand. In particular, rising real disposable

Population (without Crimea): 42.7 m
Industry/GDP: 19%
Agriculture/GDP: 10%
Investment/GDP: 14%
Exports to: Russia 18%, EU 32%
Imports from: Russia 23%, EU 39%

Real GDP growth



Source: Ukrstat

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incomes (by 5.6% yoy) resulted in growth of real private final consumption by 4.3% yoy in the second quarter. Gross fixed capital accumulation surged by 17.6% yoy (4.2% yoy in the first quarter) due to jump in spending on machinery and equipment. Investment in construction also grew. In particular, government spending on infrastructural projects increased. Investment remained primarily self-financed including savings from reduced single social contribution rate as bank financing remained low. At the same time, net real exports negatively contributed to growth as real exports declined more than imports (by 6.5% yoy and 0.1% yoy, respectively).

On the production side, real gross value added (GVA) increased in most sectors. Real GVA in agriculture increased by 0.6% yoy due to higher fruit and vegetable production. Logistic problems in June due to military conflict and strike on railways in the occupied Donbas were the major reasons for the deceleration of GVA growth in manufacturing to 3.4% yoy and decline in extractive industry by 3.7% yoy. Real GVA in construction surged by 14.9% yoy though from very low base. Higher consumption and growth of agricultural production resulted in increase of real GVA in trade while increase in production and trade of bulk items (such as steel, iron ore, grain) helped to increase GVA in transport.

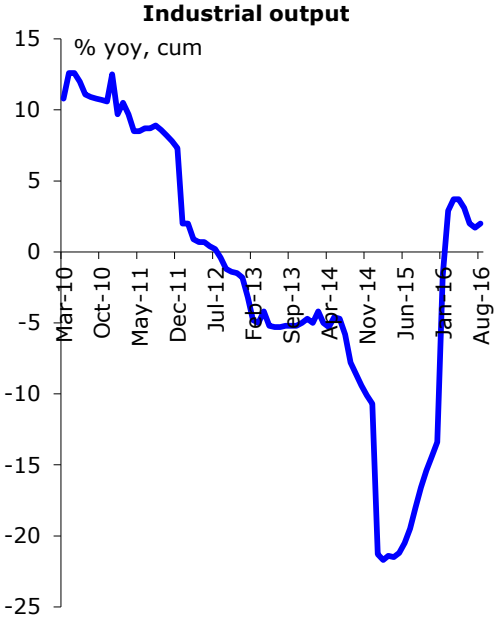
Sectoral trends. Industrial output increased by 1.5% yoy in August after growing by 0.9% yoy in July (adjusted for the number of working days; unadjusted growth was 3.4% due to two added working days). Manufacturing increased by 5.5% yoy (without working day adjustment) due to growth in most sectors. Growth in metallurgy at 5.0% yoy was ensured by higher steel production and unchanged manufacturing of tubes. Machine building grew by 1.8% yoy due to higher production of cars, agricultural machinery and equipment. Growth of chemical production accelerated to 12.4% yoy (from 7.1% yoy) likely due to imports substitution as manufacturing of paint, varnishes and household products increased. Higher meat and oil production contributed to food production increase at 1.2% yoy. At the same time, mining output fell by 1.7% yoy due to lower extraction of iron ore.

Construction increased by 12.0% yoy due to higher financing of commercial construction and infrastructural projects. At the same time, residential construction declined by 4.3% yoy due to high statistical base.

In August, growth of retail sales by enterprises accelerated to 5.2% yoy. The growth is likely explained by growth in real disposable income of households.

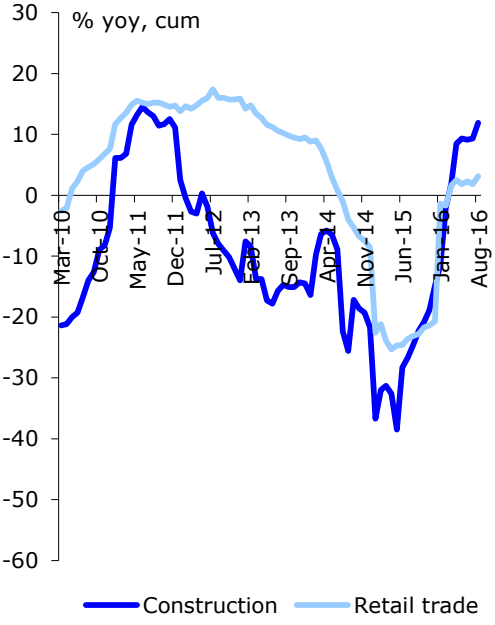
The Ukrstat publishes data excluding temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopil and the part of the territory under anti-terrorist operation in the East.

Industrial output



Note: Since April 2014 - data excludes Crimea
Source: Ukrstat

Real sector trends



Note: Since April 2014 - data excludes Crimea
Source: Ukrstat

Energy: Ukraine approves important laws

Electricity. On September 22, the Verkhovna Rada approved the Law on the National Energy and Utilities Regulatory Commission (NERC). The Law defines the responsibility of the members for the Commission's decisions and sets the rotation term of the NERC members. The law corresponds to the European legislation and is a big step forward in independence of the NERC. In particular, NERC received an independent source of financing and its decisions remain in force even when they are being disputed in court. However, it will take 1.5 years to fully change the current NERC members.

On September 22, the Verkhovna Rada also approved the Law on electricity market of Ukraine. The law attempts to establish the market of bilateral contracts and the balancing market in Ukraine. In 2013, the Parliament approved a similar law on the principles of electric energy market with the market of bilateral contracts coming into force in 2017, but its provisions were not fully realized.

Both laws are yet to be signed by the President but the probability of signing is very high.

Naftogaz reform. On September 7, the Ministry of Economic Development and Trade changed the statute of the Naftogaz transferring the right to name the members of the Supervisory Council and the Board of Ukrtransgaz from the Board of the Naftogaz of Ukraine to the general meeting of shareholders of the Naftogaz. In addition, the Ministry transferred the right to change the statute of the Ukrtransgaz and approve its financial plan and investment program to the general meeting of the Naftogaz shareholders.

The European Bank of Reconstruction and Development (EBRD) stated that this decision violates the USD 300 m credit agreement between the EBRD and the Government of Ukraine on purchasing the natural gas and urged to cancel the Ministry's decision. The Naftogaz said that the decision also violates the USD 500 m credit agreement with the World Bank. On September 19, the Ministry suspended the changes to the statute of the Naftogaz until April 2017. The Minister of Economy considers the change in governance of the Ukrtransgaz the correct decision but admits the lack of consultations on the issue.

On September 22, the governance over the Naftogaz was transferred from the Ministry of Economic Development and Trade to the Cabinet of Ministers to streamline the reform of the Naftogaz.

Transparency. The Cabinet of Ministers obliged heat and water suppliers to make their investment programs available to the public. The companies have to publish reports on fulfilling the programs, which will allow establishing public control over the programs, increasing the quality of the provided services, and fighting corruption in the sector.

Transport. Ukraine develops new transit routes

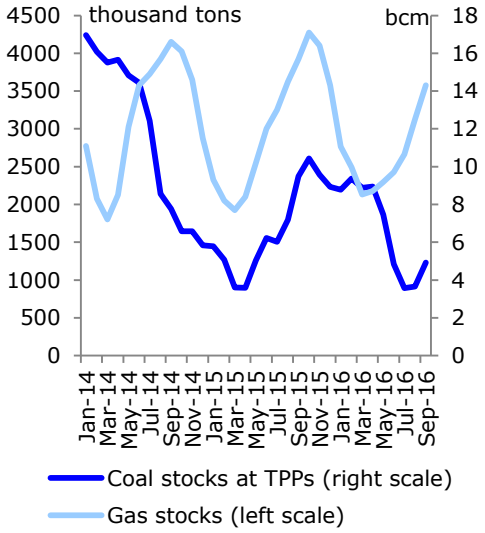
Railway. Ukraine and Georgia signed an agreement on organisation of direct international railway-sea route between the ports of Chornomorsk and Batumi. This agreement is part of the bigger New Silk Route negotiations on organising fast cargo transportation between China and Europe. One of the lines of the route goes via Kazakhstan, Azerbaijan, Georgia and Ukraine. The biggest obstacles to this successful implementation of this project remain high port fees and the lack of ferries in the Black Sea. The first attempt to use this route was made in January 2016 when it took the container train 16 days to go from Ukrainian port of Chornomorsk to Dostyk station on the Kazakhstan-China border.

Agriculture: Revision of tariff free quotas to EU

Production. Gross agricultural production in August decreased by 0.9% yoy due to decline in dairy and egg production. Dairy production suffered from regulated milk prices against the background of increased production costs, as a result production of milk declined by 3.8% yoy. Egg production contracted by 4.9% yoy primarily due to disruption of exports. Favourable weather conditions contributed to increase in production of grains, leguminous crops, sugar beet, and sunflower seed.

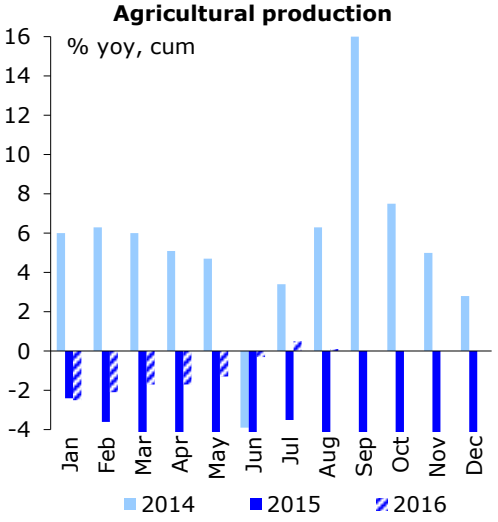
Trade policy. In September, the European Commission proposed to enlarge the tariff free import quotas for Ukrainian exporters under the EU-Ukraine DCFTA. Quotas will be increased for sectors with a large number of small and medium enterprises. According to the proposal, annual quota in 2017 for honey will be increased by 60% to 8 000 tones, quota for apple and grape juice will be increased by 5% to 10 500 tones, and quota for processed tomatoes will be increased by 50% to 15 000 tones. Quotas will be also raised for commodities in high demand in the EU: quota for barley will be increased by 40% to 350 000 tones; quota for corn will be increased by 60% to 650 000 tones. At the same time, quota for poultry meat will not be changed likely due to the monopolisation of poultry market in Ukraine by several large companies. These proposed by the EC changes are still to be ratified by the EU Parliament.

Coal and gas stocks



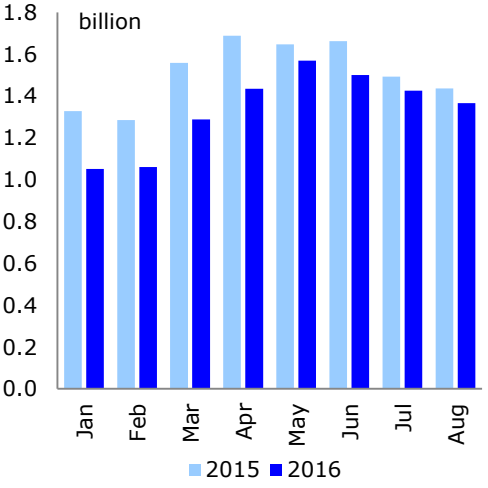
Source: Ministry of Energy

Agricultural production



Source: Ukrstat

Egg production



Source: Ukrstat

External sector: Financial account surplus balanced current account deficit

Current account. Current account in August was in deficit at USD 0.4 bn as compared to balanced current account in August 2015. Current account deficit resulted from higher merchandise trade deficit at USD 0.7 bn due to faster recovery of imports (as compared to USD 0.3 bn in August 2015). Faster recovery of imports also led to balancing trade in services (as compared to surplus at USD 0.1 a year ago). Net inflow of primary income remained close to zero, including net outflow of investment income at USD 0,4 bn. Remittances from abroad increased by 25.5% yoy to USD 0.3 bn. Net outflow of investment income amounted to USD 0.4 bn.

Exports of goods increased by 1.0% yoy (as compared to drop at 10.0% in July 2016). Exports of food increased by 5.5% yoy due to higher export volumes of grains, while prices remained low. Exports of metals increased by 4.7% yoy due to both higher prices and higher demand. In particular, Ukrainian steel producers benefited from antidumping measures imposed by the EU against Russian and Chinese steel. Higher exports of minerals (by 13.2% yoy), wood (by 4.7% yoy) and industrial goods (by 3.9%) was primarily explained by statistical base effect. Exports of chemicals decreased by 9.4% yoy as the industry remained depressed. Decline in exports of machinery accelerated to 31.8% yoy from 24.8% yoy in July as Ukraine has already fulfilled obligations under contracts with Turkmenistan. Exports of services increased by 2.4% yoy due to higher exports of transportation and computer services.

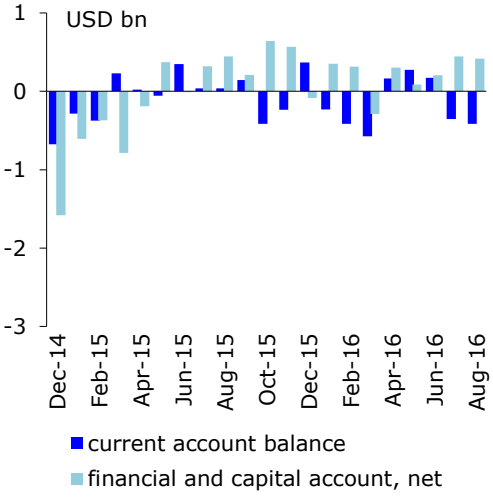
Increase in merchandise imports accelerated to 14.9% yoy (as compared to 1.2% yoy in July 2016). Increase in non-energy imports accelerated to 26.6% yoy (as compared to 10.9% yoy in July 2016) due to recovery of both investment and consumer demand. Higher consumer demand led to acceleration of growth of imports of food and industrial goods. Higher imports of machinery (at 57.7% yoy) was explained by larger purchases of agricultural machines as well as higher imports of passenger cars. Imports of chemicals increased by 13.7% yoy due to high purchases of fertilizers. Acceleration of imports of metals increase to 25.7% yoy was supported by recovery of construction and machine building. Decline in imports of minerals further decelerated to 16.9% yoy (as compared to 27.2% yoy in July 2016) as Ukraine increased purchases of natural gas from the EU and raw oil for Kazakhstan. Imports of services increased by 8.3% yoy due to more foreign travels.

Financial account. Financial account surplus in August amounted to USD 0.4 bn (as compared to USD 0.5 bn in August 2015). Net inflow of FDI decreased to USD 0.1 bn, but 87% of them were allocated to the real sector. The Government sector yet did not attract external financing in August, but repaid some outstanding debt. External assets of banking sector decreased by USD 0.2 bn, while real sector was able to attract USD 0.1 bn of external debt financing. Increase in exchange rate volatility likely was the major reason for contraction of net sales of cash foreign currency to the banking sector by USD 0.3 bn to USD 0.3 bn.

Fiscal policy: Draft State Budget for 2017 was submitted

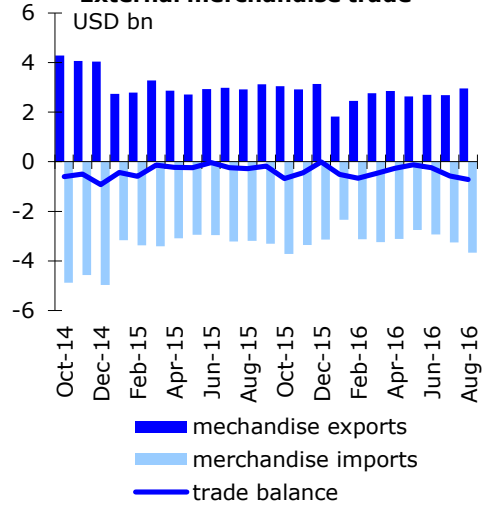
Revenues. According to the preliminary information of the State Treasury, consolidated fiscal revenues in September increased by 6.4% yoy, which is close to growth in July (in August record increase in revenues at 26.5% yoy was explained by changes in corporate income tax payment schedule). The NBU was still not able to transfer the profits to the budget due to prolonged delay in forming NBU Council. Tax revenues increased by 45.0% yoy due to higher collections of most taxes. PIT revenues increased due to higher effective rate and wage growth. Higher consumption contributed to larger VAT and excise duty revenues. At the same time, rent payments remained lower than planned due to over-optimistic plan and poor administration.

Balance of payments



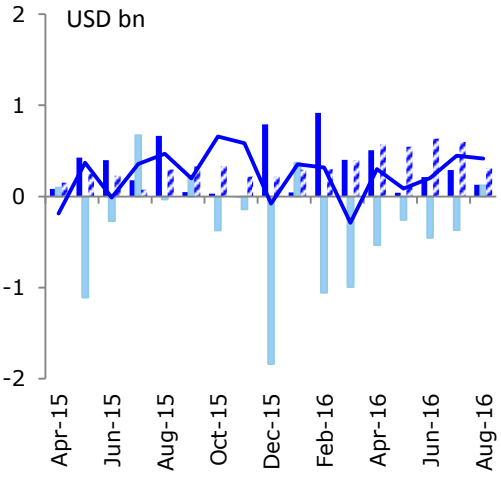
Source: NBU preliminary estimates

External merchandise trade



Source: NBU preliminary estimates

Financial account



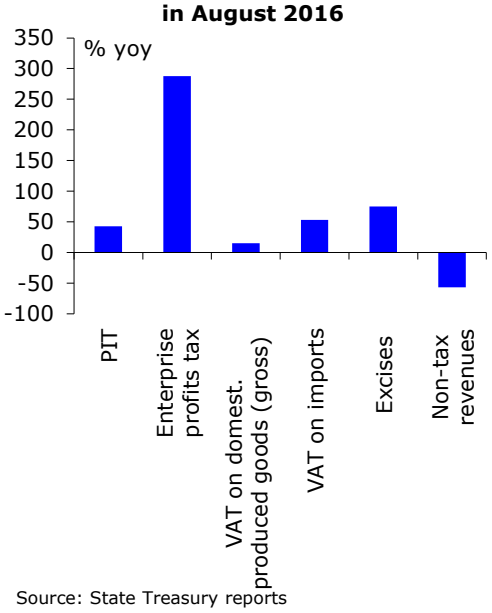
Source: NBU

Expenditures. Consolidated fiscal expenditures in August increased by 24.2% yoy (20.3% yoy in July). In particular, financing of capital outlays increased by 23.9% yoy (13.9% yoy in July). Sharp increase of salaries of public employees as well as military wages upped total spending on wages by 23.4% yoy despite decline in the single social contribution rate (SSC). At the same time, transfer to the Pension Fund and financing of social assistance payments (including housing and utility subsidies) surged by 64.1% yoy.

Deficit. The consolidated fiscal deficit in eight months of the year declined to UAH 11.3 bn from UAH 22.9 bn between January and July.

State Budget 2017. The Government submitted the draft State Budget Law for 2017 on September 15 as required by the Budget Code schedule. Central fiscal revenues are planned to increase by 16.1% in nominal terms. In relation to GDP they are officially estimated to reach 27.3% of GDP (increase by 0.4 p.p.). This reflects in part increase excise rates proposed in accompanying amendments to the Tax Code. Expenditure (including credits) are planned at UAH 784 bn or 30.3% of GDP. The Ministry of Finance proposed the structure of expenditures similar to this year's Budget. Fiscal deficit is planned at UAH 77.5 bn or 3.0% of GDP that will be financed by mix of official borrowing and privatization. Overall, the proposed 2017 Budget does not contain any major reforms but it is based on rather realistic macroeconomic scenario and foresees reasonable increase in social standards.

Growth of Consolidated fiscal revenues in August 2016



Source: State Treasury reports

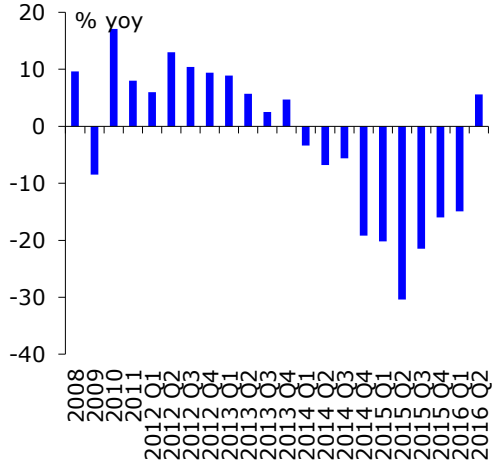
Social policy: Growth of disposable income

Income. Disposable income in the second quarter of 2016 increased by 14.3% yoy in nominal terms due to higher revenues from all sources. Wage income increased by 26.1% yoy due as wages gradually caught up with sharp increase in prices in 2015. At the same time, income from social welfare payments and current transfers grew by 12.3% yoy due to moderate increase in minimum pensions, other social payments, housing and utility subsidies. Income from subsidiary farming and entrepreneurship increased grew by only 6.4% yoy in response to slow increase in food and personal services prices and low demand.

Real disposable income grew by 5.6% yoy (as compared to decline at 14.9% yoy in the first quarter) due to nominal income growth and lower inflation.

Subsidies. The Government introduced changes into the procedures of provision of housing and utility subsidies (HUS). In particular, it changes presumed income for applicants without proven income. Income of individuals without any formal income would be counted at the level of two sizes of subsistence minimum. Such ad hoc measures are frequently introduced by the Government during recent years after it substantially simplified the application procedures for the HUS. The revision of income level, which is taken into account when assessing the eligibility of a household for the subsidy, is expected to reduce the fraud. However, it might also hurt those who is in real need (e.g., due to the loss of work). Overall, this decision raises the issue of the importance and urgency for the full-scale social welfare reform.

Real disposable household incomes



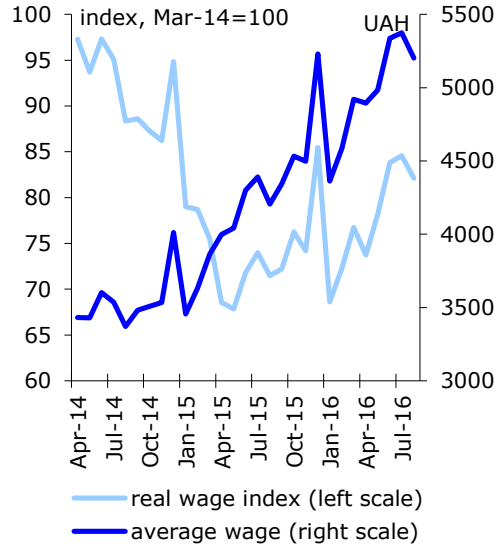
Source: Ukrstat

Labour market: Half year of uninterrupted real wage growth

Wage. Average nominal wage in August grew by 23.7% yoy to UAH 5202 due to increase in minimum wage, decrease in the rate of Single Social Contribution and increases of salaries in public sectors. Besides, companies increased wages to compensate for high inflation in the first half of 2015. Growth of real wage accelerated to 15.4% yoy due to the slowdown of inflation.

Nominal wage in industry increased by 19.9% yoy. Real wage increased in every sector of industry except for manufacturing of coke and refined petroleum products. Major enterprises of the latter sector were heavily affected by the war in Eastern Ukraine; average wage in the sector decreased by 6.2% yoy in nominal terms. Macroeconomic

Average wage*



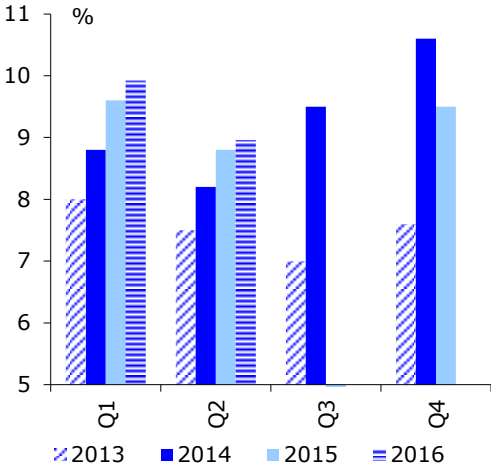
*not including AR Crimea
Source: Ukrstat

stabilisation and increase in prices for imported goods resulted in growth of demand for domestic products. As a result, financial results of enterprises of textile, pharmaceutical and food industry enabled them to raise average wages for their employees by 34.7% yoy, 32.2% yoy, and 23.9% yoy, respectively. Metallurgy increased wages by 12.7% yoy due to disruptions in production. Increased housing and utility tariffs allowed enterprises in the electricity and gas supply sector to raise average wage for their employees by 28.3% yoy.

Wages were increased gradually in public sectors. Wages increased by 24.2% yoy in education and by 25.3% yoy in healthcare due to the increase in salaries along the unified tariff scale. Wages in state administration and defence grew by 37.4% yoy as the Cabinet of Ministers increased base salaries of civil servants since May 1.

Unemployment. In the second quarter of 2016, unemployment rate (ILO methodology) increased by 0.2 p.p. to 9.0% of economically active population at age 15-70 years old. This is likely an indication of stabilisation of the labour market situation against the background of improved performance of most economic sectors. Unemployment rate in all regions remained close to the levels of the second quarter of 2015.

Unemployment rate (ILO)



* 2014 - without Crimea, 2015 - without Crimea and occupied territory in the East
Source: Ukrstat

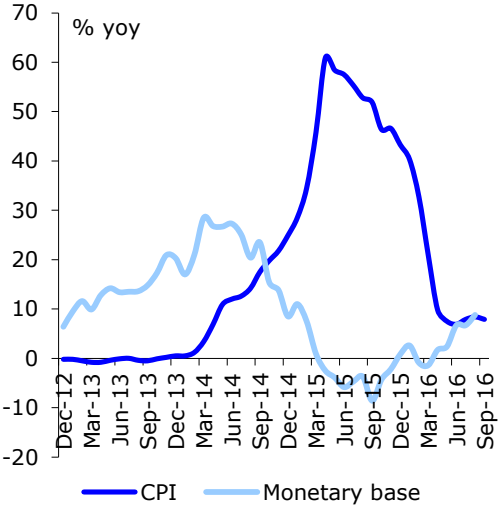
Monetary policy: Inflation slows to 7.9% yoy

Consumer inflation slowed to 7.9% yoy in September from 8.4% yoy in August. Price index for food products increased only by 4.2% yoy with single-digit price increases for most components. Notable exceptions were vegetables where prices were lower by 19% yoy and milk products where prices where by 13-22% yoy higher and sugar that became 15% yoy higher. This likely reflected high harvest of vegetables and falling milk production. Low competition in milk production and low bargaining power of small producers likely led to high gap between purchasing, wholesale and retail prices.

Core inflation that excludes administered prices as well as energy and raw food products slowed to 6.3% yoy. Consumer demand despite recent increase remains weak enough to keep inflation pressure low and global commodity prices remain moderate. Impact of the slight hryvnia depreciation in August and September on imported goods prices seemed low. Housing and utility price index increased by 15.8% yoy as heating and hot water tariff jumped by 77% yoy and electricity tariff by 60% yoy.

In September, the NBU reduced policy rate for the fifth meeting of the MPC in a row. The NBU discount rate now reached 15% p.a. (down from 15.5% p.a. set in July). Interest rates on corporate loans and deposits continued to go down in line with less tight monetary policy but a slow pace.

CPI and monetary base development



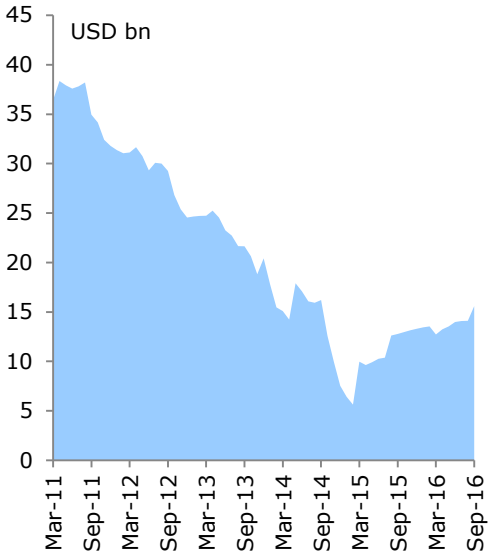
Source: Ukrstat, NBU

Exchange rate: Volatility remains moderate in September

Interbank exchange rate remained in UAH 25.8-26.8 per USD range in the in September. Hryvnia weakened in the first half of the month and was getting close to UAH 27 per USD but bounced back to below UAH 26 per USD in the second half of September. Both supply and demand on the interbank market increased in September in response to seasonal increase in consumer and investment demand as well as higher grain exports. The NBU helped reduce volatility on the market by selling USD 178 m (and bought USD 48 m in the end of the month).

Successful completion of the long-delayed second review of the IMF Program may have helped calm depreciation expectations. International reserves jumped to USD 15.6 bn in September as the NBU received USD 1 bn from the IMF. Government also received USD 0.5 bn in net foreign currency inflows (with USD 1 bn received from US-guaranteed Eurobonds, USD 0.5 bn spent on biannual coupon on restructured Eurobonds, balanced flows on other debt).

NBU international reserves



Source: NBU

State debt: Increased external borrowings

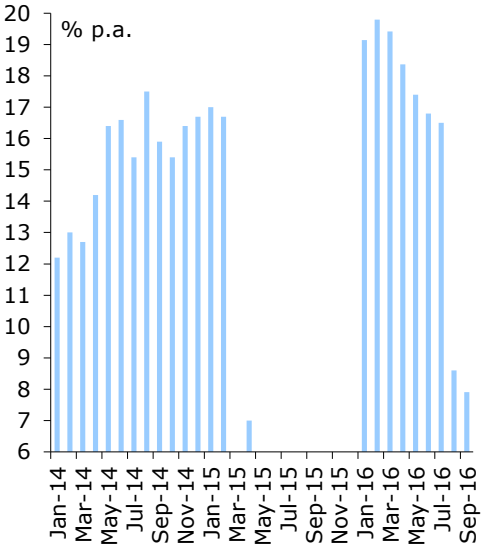
External debt. On September 16, Ukraine received the third IMF tranche of USD 1.0 bn after the second review of its Extended Fund Facility (EFF) program. The funds were borrowed by the NBU to replenish foreign reserves.

The approval of the Second Review of the Program became a positive sign for investors and other official international donors. It enabled the Government to place USD 1 bn five-year U.S.-guaranteed bonds at the lowest interest rate (1.471% p.a.).

The Government expects to receive a EUR 0.6 bn loan under EU macro-financial assistance program by the end of 2016. For this it will be required to continue energy reform.

Domestic debt. In September, the Ministry of Finance placed UAH 5.9 bn of state domestic bonds with weighted average yield at 7.9% p.a. as compared to UAH 4.7 bn at 8.6% p.a. in August. The USD-indexed bonds accounted for near 85% of the total placement and were sold at the lower interest rate (6.5% p.a.) to refinance UAH 1.9 bn of indexed bonds issued in October 2011. The Government also issued USD 100 m of two-year USD-denominated bonds with yields at 6.5% p.a.

Weighted average yield for domestic state bonds



Source: NBU

Tables

		Q3 14	Q2 15	Q3 15	Q4 15	Q1 16	Q2 16	Q3 16	Mar	Apr	May	Jun	Jul	Aug	Sep
Industrial production (real)	% yoy cum.	-8.0	-20.0	-16.1	-13.0	3.7	2.0	…	3.7	3.7	3.1	2.0	1.7	2.0	…
Construction (real)	% yoy cum.	-16.4	-26.2	-20.9	-12.3	1.9	9.1	…	1.9	8.5	9.3	9.1	9.3	11.9	…
Agricultural production (real)	% yoy cum.	16.0	-9.3	-5.3	-4.8	-1.7	-0.3	…	-1.7	-1.7	-1.3	-0.3	0.5	0.1	…
Retail trade turnover (real)	% yoy cum.	-5.3	-24.6	-22.3	-20.7	1.6	2.3	…	1.6	2.5	1.8	2.3	2.4	3.1	…
Average wage	UAH	3463	4113	4313	4753	4622	5072	…	4920	4895	4984	5337	5374	5202	…
CPI	% yoy eop	17.5	57.5	51.9	43.3	20.9	6.9	7.9	20.9	9.8	7.5	6.9	7.9	8.4	7.9
PPI	% yoy eop	26.9	37.9	32.5	25.4	10.5	15.7	19.6	10.5	10.1	16.4	15.7	18.3	18.9	19.6
Exports (USD)*	% yoy cum.	-16.4	-32.2	-29.8	-27.0	-16.4	-9.7	…	-16.4	-12.3	-10.3	-9.7	-9.5	-8.5	…
Imports (USD)*	% yoy cum.	-24.8	-34.2	-31.8	-29.3	-10.9	-6.2	…	-10.9	-8.3	-7.3	-6.2	-5.0	-2.0	…
Trade balance	USD bn cum.	-3.0	-0.6	-1.0	-1.7	-1.6	-2.0	…	-1.6	-1.7	-1.3	-2.0	-2.5	-3.6	…
Current account**	USD bn cum.	-1.2	-0.1	0.1	-0.2	-1.0	-0.2	…	-1.0	-0.6	-0.4	-0.2	-0.5	-1.4	…
Gross international reserves	USD bn eop	16.4	10.3	12.8	13.3	12.7	14.0	15.6	12.7	13.2	13.5	14.0	14.1	14.1	15.6
Monetary Base	% yoy eop	23.5	-5.9	-8.6	0.8	-1.4	1.7	…	-1.4	1.7	2.4	6.7	6.7	8.8	…
Lending rate on UAH credits	% pa, aop	16.4	23.1	21.1	20.7	20.0	20.9	20.8	20.3	20.9	21.1	20.6	18.0	17.0	…
Exchange rate (interbank)	USD aop	12.58	21.56	21.74	22.90	25.69	25.2	25.68	26.30	25.54	25.21	24.93	24.82	25.14	26.23
Exchange rate (official)	USD aop	12.58	21.62	21.69	22.33	25.68	25.3	25.74	26.39	25.63	25.21	24.95	24.82	25.65	26.28
Exchange rate (official)	EUR aop	24.37	23.93	24.69	24.91	28.34	28.6	28.96	29.33	29.06	28.50	28.09	27.49	28.65	29.47

Sources: Ukrstat, NBU, own calculations

* Trade in goods and services

Key Economic Indicators		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010[c]	2011[c]	2012[c]	2013[c]	2014[c]	2015[c]
Nominal GDP	UAH bn	170.1	204.2	225.8	267.3	345.1	441.5	544.2	720.7	948.1	913.3	1079.3	1300.0	1404.7	1465.2	1568.9	1979.5
Nominal GDP	USD bn	31.3	38.0	42.4	50.1	64.9	86.2	107.8	142.7	179.9	117.2	136.0	163.1	175.8	183.3	132.2	90.6
GDP growth (real)	% yoy	5.9	9.2	5.2	9.6	12.1	2.7	7.3	7.9	2.3	-14.8	4.1	5.5	0.2	0.0	-6.6	-9.9
Industrial production	% yoy	13.2	14.2	7.0	15.8	12.5	3.1	6.2	7.1	-5.0	-20.6	12.2	8.0	-0.7	-4.3	-10.1	-13.0
Agricultural production	% yoy	9.8	10.2	1.2	-11.0	19.7	-0.1	0.4	-5.2	17.5	0.1	-1.4	20.2	-3.9	13.6	2.2	-4.8
CPI	% yoy aop	28.2	12.0	0.8	5.2	9.0	13.5	9.1	12.8	25.2	15.9	9.4	8.0	0.6	-0.3	12.1	48.7
CPI	% yoy eop	25.8	6.1	-0.6	8.2	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	43.3
PPI	% yoy aop	20.9	8.6	3.1	7.6	20.5	16.7	9.6	19.5	35.5	6.5	20.9	19.0	3.7	-0.1	17.1	36.0
PPI	% yoy eop	20.8	0.9	5.7	11.1	24.1	9.5	14.1	23.3	23.0	14.3	18.7	14.2	0.3	1.7	31.8	25.4
Exports (gs, USD)	% yoy	17.9	9.5	10.7	24.0	42.6	7.5	13.4	27.0	34.3	-36.9	26.0	27.5	3.4	-5.5	-19.9	-27.0
Imports (gs, USD)	% yoy	18.9	14.1	4.9	28.7	31.3	20.4	22.6	35.232	39.3	-44.2	28.8	34.8	7.5	-3.5	-28.1	-29.3
Current account	USD bn	1.5	1.4	3.1	2.9	6.9	2.5	-1.6	-5.3	-12.8	-1.7	-3.0	-10.2	-14.3	-16.5	-4.6	-0.2
Current account	% GDP	4.8	3.7	7.3	5.8	10.6	2.9	-1.5	-3.7	-7.1	-1.5	-2.2	-6.3	-8.2	-9.0	-3.5	-0.2
FDI (net)	USD bn	0.6	0.8	0.7	1.4	1.7	7.5	5.7	9.218	9.9	4.7	5.8	7.0	7.2	4.1	0.3	3.0
International reserves	USD bn	1.5	3.1	4.4	6.9	9.7	19.4	22.4	32.5	31.5	26.5	36.7	31.8	31.4	20.4	7.5	13.3
Fiscal balance'''	% GDP	-0.7	-1.9	0.8	-0.2	-3.0	-1.9	-0.7	-1.1	-1.5	-2.4	-6.0	-1.8	-3.6	-4.4	-4.6	-1.6
Total state debt	% GDP eop	45.3	36.5	33.5	29.0	24.7	17.7	14.8	12.5	19.9	33.0	40.0	36.0	37.5	39.9	69.4	79.4
External state debt (total)	% GDP eop	33.0	26.3	24.1	21.4	18.6	13.4	11.7	9.8	15.0	21.5	25.6	22.8	22.1	20.5	38.5	52.7
Monetary base	% yoy eop	39.9	37.4	33.6	30.1	34.1	53.9	17.5	46.0	31.5	4.4	15.8	6.3	6.4	20.3	8.5	0.8
Exchange rate	USD aop	5.44	5.37	5.33	5.33	5.32	5.12	5.05	5.05	5.27	7.79	7.94	7.97	7.99	7.99	11.87	21.84
Exchange rate	USD eop	5.44	5.30	5.33	5.33	5.31	5.05	5.05	5.05	7.70	7.98	7.96	7.99	7.99	7.99	15.77	24.00
Exchange rate	EUR aop	5.03	4.81	5.03	6.02	6.61	6.39	6.34	6.92	7.71	10.87	10.53	11.09	10.27	10.61	15.72	24.23
Exchange rate	EUR eop	5.10	4.67	5.53	6.66	7.22	5.97	6.65	7.42	10.86	11.68	10.57	10.54	10.30	11.04	19.26	26.22

Sources: Ukrstat, NBU, Ministry of Finance, own calculations

''' "Minus" denotes a consolidated fiscal deficit; without recapitalisation

[c] Data excludes Crimea where available

Notes:

avg	average	**ytd**	year-to-date	**NBU**	National Bank of Ukraine
cum	cumulative	**p.a.**	per annum	**EPT**	Enterprise profit tax
mom	month on month change	**eop**	end of the period	**VAT**	Value added tax
qoq	quarter on quarter change	**aop**	average of the period	**Ukrstat**	State Statistics Service of Ukraine
yoy	year-on-year change	**gs**	goods and services		

Quarterly trends

National accounts		Q1 12	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14c	Q2 14c	Q3 14c	Q4 14c	Q1 15c	Q2 15c	Q3 15c	Q4 15c	Q1 16	Q2 16
GDP	UAH bn	292.3	387.1	379.2	303.8	354.8	398.0	408.6	316.9	382.4	440.5	447.1	375.5	455.2	563.9	584.8	453.2	531.8
GDP (real)	% yoy	2.4	-1.3	-2.4	-1.3	-1.2	-1.1	3.4	-1.0	-4.3	-5.3	-14.4	-17.0	-14.7	-7.2	-1.4	0.1	1.4
Household consumption (real)	% yoy	7.1	10.2	4.9	5.9	8.7	6.8	6.3	3.3	-7.8	-13.9	-12.2	-20.7	-28.1	-19.3	-13.0	-2.2	4.3
State consumption (real)	% yoy	3.5	9.7	1.1	2.0	-0.9	-1.5	-2.9	-5.9	5.2	0.1	4.5	2.7	-5.9	-1.7	8.1	0.1	-2.4
Gross fixed capital formation (real)	% yoy	15.3	-2.9	-2.1	6.1	-18.1	-8.9	-8.7	-19.9	-19.3	-28.0	-26.5	-22.8	-13.8	-6.3	1.4	4.2	17.6
Exports of goods and services (real)	% yoy	-7.4	-1.8	-7.2	-7.4	-13.5	-6.8	-4.5	-5.1	-2.3	-16.8	-31.1	-26.1	-22.1	-10.8	-5.8	-3.8	-6.5
Imports of goods and services (real)	% yoy	-2.9	6.6	-0.2	1.3	-15.7	1.7	-0.6	-11.8	-10.9	-32.3	-29.6	-19.8	-32.1	-18.2	-17.3	-7.2	-0.1
Agriculture, hunting, forestry (real)*	% yoy	0.4	-8.0	-3.5	5.7	21.7	-2.8	36.5	5.7	-9.1	25.6	-20.6	-4.7	-11.8	-3.8	-3.6	-1.6	0.6
Manufacturing industry (real)*	% yoy	2.5	-4.9	-6.6	-9.3	-9.9	-10.6	-9.8	-3.2	-5.4	-12.7	-13.2	-24.4	-20.7	-7.9	-0.2	6.9	3.4
Construction (real)*	% yoy	-4.9	-14.3	-18.7	-16.1	-19.4	-8.0	-4.4	4.7	-14.0	-26.3	-30.8	-30.4	-24.2	-9.1	10.8	6.8	14.9
Trade, repair services (real)*	% yoy	2.1	-0.5	-2.0	0.2	-1.2	0.9	0.9	-3.0	-7.2	-18.4	-26.6	-25.0	-19.8	-13.6	-6.1	3.7	7.1
Transport (real)*	% yoy	-2.6	-8.3	-10.5	-1.7	-0.8	1.3	2.7	-7.8	-10.9	-10.1	-11.0	-8.2	-2.3	-0.2	4.9	5.4	2.8
Balance of payments (BPM6)																		
Current account balance	USD bn	-1.9	-3.9	-4.8	-3.2	-2.3	-6.0	-5.0	-1.3	-0.8	-1.2	-1.4	-0.4	0.3	0.2	-0.3	-1.2	0.6
Current account balance	% of GDP	-5.2	-8.1	-10.1	-8.4	-5.1	-12.1	-9.8	-3.5	-2.5	-3.3	-6.7	-2.4	1.5	0.9	-1.1	-6.9	2.9
Trade balance in goods	USD m	-4292	-5503	-6233	-4635	-3677	-7881	-5935	-2195	-1185	-1412	-2336	-1111	-470	-662	-1066	-1655	-615
Trade balance in services	USD m	1864	2361	1578	1349	1504	2575	1066	937	443	456	686	555	388	278	397	263	293
Direct investment (FDI)*	USD m	2012	2037	1876	1082	496	1510	991	-665	-319	725	558	397	907	890	818	1367	759
Gross international reserves	USD bn	31.1	29.3	24.5	24.7	23.2	21.6	20.4	15.1	17.1	16.4	7.5	10.0	10.3	12.8	13.3	12.7	14.0
Exchange rate (interbank), UAH/USD	aop	8.03	8.09	8.11	8.11	8.14	8.15	8.21	9.14	11.71	12.58	13.56	21.23	21.26	21.74	22.90	25.69	25.23
Exchange rate (official), UAH/USD	aop	7.99	7.99	7.99	7.99	7.99	7.99	7.99	8.86	12.71	12.58	21.18	21.33	21.23	21.69	22.33	25.68	25.26
Fiscal indicators																		
Consolidated fiscal revenues	% of GDP	33.7	28.2	33.6	35.2	29.4	28.9	28.6	35.4	29.4	24.7	27.4	37.3	34.8	37.2	40.4	36.1	38.7
Personal income tax	% of GDP	5.1	4.5	5.0	5.3	5.1	4.6	4.8	5.1	4.7	4.2	5.0	5.5	5.3	5.6	6.6	6.3	7.4
Enterprise profits tax	% of GDP	4.9	2.9	4.2	6.1	3.4	3.0	3.0	4.9	2.5	1.9	1.5	4.4	1.7	1.5	1.7	3.6	2.4
Value-added tax	% of GDP	10.8	8.6	10.0	9.7	9.0	8.1	8.4	8.7	9.5	6.8	10.1	11.4	9.2	10.0	10.6	11.7	13.4
Excise tax	% of GDP	2.8	2.8	2.4	3.1	2.6	2.3	2.2	2.5	3.0	3.0	2.8	3.3	3.4	3.7	4.0	4.2	6.0
Consolidated fiscal expenditures	% of GDP	33.9	30.7	41.3	36.9	35.8	30.1	35.9	35.2	34.7	27.2	35.5	33.6	35.0	32.5	54.2	35.3	41.8
Current expenditures	% of GDP	31.9	27.8	37.3	35.6	33.9	28.2	33.2	34.8	33.7	25.8	33.6	31.8	33.7	29.9	49.2	34.4	39.9
Capital expenditures	% of GDP	1.9	2.9	4.0	1.3	1.9	1.9	2.8	0.5	1.0	1.4	1.9	1.7	1.3	2.6	5.0	0.9	2.0
Consolidated fiscal balance	% of GDP	-0.2	-3.0	-7.8	-1.9	-6.3	-1.5	-7.3	0.1	-5.3	-2.8	-8.8	3.7	-0.4	4.4	-13.9	0.9	-3.3
Privatisation receipts	% of GDP	1.4	0.1	0.4	0.0	0.0	0.2	0.1	0.0	0.0	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Banking system																		
Monetary aggregate M0	% yoy cum	4.7	5.2	5.5	9.7	9.8	12.3	17.0	19.2	31.9	28.8	19.0	6.0	-1.3	-6.2	-0.1	-5.3	0.3
Monetary aggregate M2	% yoy cum	11.2	10.7	13.1	16.0	17.9	19.2	17.5	17.7	13.4	14.2	5.4	9.0	3.1	5.6	4.0	-1.7	6.3
Household deposits in national currency	% yoy cum	14.4	16.3	16.3	19.1	26.5	33.4	38.0	7.9	-2.3	-12.3	-22.1	-19.1	-17.7	-16.6	-1.0	4.3	9.4
Household deposits in foreign currency	% yoy cum	12.4	17.0	21.8	17.0	14.7	8.4	0.9	19.8	10.2	5.5	18.0	25.4	11.6	3.7	-2.4	-16.1	-2.7
Com. bank credits in national currency	% yoy cum	17.4	9.1	7.7	8.6	7.4	10.2	16.9	12.3	4.9	-0.8	-9.1	-11.0	-11.8	-15.8	-20.8	-16.6	-13.3
Com. bank credits in foreign currency	% yoy cum	-7.0	-9.9	-7.3	-4.4	-0.4	0.8	2.8	36.4	38.5	49.1	53.5	58.4	29.2	18.7	15.9	-15.0	-2.0
Long-term com. bank credits	% yoy cum	-2.9	-8.0	-6.6	-5.6	-2.7	-0.5	2.9	26.3	24.4	24.6	21.7	17.9	3.1	-5.7	-10.5	-18.1	-10.3
Long-term com. bank credits	% of total	61.5	59.1	57.8	55.9	55.7	55.1	53.2	58.5	59.1	59.8	59.5	58.5	57.6	60.7	55.4	55.6	54.5
Average lending rate on national currency credits	% p.a.	15.5	19.5	20.8	16.2	15.3	15.3	16.5	18.4	17.5	16.4	16.6	19.9	23.1	21.1	20.7	20.0	20.9
Average lending rate on foreign currency credits	% p.a.	8.2	8.5	8.8	9.4	9.7	9.6	8.8	8.7	9.4	9.2	8.8	8.2	9.3	9.2	9.1	8.9	9.1

Sources: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, Reuters, IER estimates
* change in value added

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