Monthly Economic Monitor Ukraine

No.5 (175), May 2015

EXECUTIVE SUMMARY

HIGHLIGHT: INFLATION RECORDS

Politics: Long-awaited conference of international donors and investors had moderate results likely due to slow pace of reforms in Ukraine.

Real Sector: The industrial output in March contracted by 21.1% yoy due to protracted impact of military conflict in Donetsk and Luhansk oblasts as well as weak external and domestic demand.

Energy sector: The Verkhovna Rada adopted a law *On the Natural Gas Market*, which stipulates expected for a long time gas market reform.

Agriculture: In March 2015 gross agricultural production declined by 6.8% yoy.

External sector: Current account in March was balanced mainly as merchandise trade deficit narrowed to USD 0.2 bn.

Fiscal policy: Consolidated fiscal revenues in March surged by 48.8% yoy due to acceleration of inflation, hryvnia depreciation, tax amendments, and receipts from 3G licences.

Social policy: The Government submitted to the Verkhovna Rada draft laws in the framework of promised pension reform.

Labour market: Average wage in March dropped by 24.6% yoy in real terms due to sharp acceleration of inflation.

Monetary policy: In April, consumer prices reportedly increased by 14% mom, what reflects one-off revision in gas and electricity prices for households.

Exchange rate: Peak redemptions and interest payments on foreign currency bond led Ukraine's international reserves to decrease to USD 9.6 bn by the end of April.

State debt: The EU approved the third MFA programme for Ukraine at EUR 1.8 bn.

Highlight of the month: Inflation records

IS GENIE OUT OF THE BOTTLE?

by Vitaliy Kravchuk

In April consumer inflation reached 60.9% yoy. Introduction of new tariffs for gas and electricity in April added about 14 p.p. to consumer inflation. As a result, inflation reached the highest level since 1996. However, we believe that impact of tariff increase on price level was lower than estimated by the Ukrstat. This reflected complexity of change in gas pricing. Regulators replaced eight-tier tariff (depending on use case, availability of gas meter and annual volume of consumption) that was uniform throughout the year with seasonal two-tier tariff. Lower price is charged for the first 200 cubic meters of gas (in month) consumed by customers with individual gas heating during heating season and higher ("market") price is charged for all other gas consumed (by all consumers). CPI reflected price increase by 453%, which is a tariff increase for consumers without gas meters and without individual gas heating. However, gas bill for these consumers (about 20% of total gas consumers) in fact increased by 177% due to change in the imputed gas usage. Other 80% of gas consumers had different outcomes summarized in the Table.

We can estimate average gas price increase at 234% during heating season and 413% outside of heating season with overall price increase of 255%. This is similar to gas price increase foreseen in the IMF program (285%)[1]. If the Ukrstat used 255% figure (which is appropriate as consumer basket has fixed weights throughout the year), CPI would have increased by 10.0% from previous month and consumer inflation would be somewhat lower at 55.2% yoy. If we also adjust for excessively high share of gas bill in consumer basket we reach 8.6% mom headline inflation.

Gas price increase in % and in per capita gas bill	October-April	May-September
Users without gas heating and meters	177% (UAH 14-41)	
Users with meters and without gas heating	508% (UAH 22-68)	
Gas heating using <200 m^3 per month (2 persons)	231% (<UAH 251)	560% (UAH 69)
Gas heating using 300 m^3 per month (3 persons)	340% (UAH 370)	560% (UAH 69)
Gas heating using 400 m^3 per month (4 persons)	202% (UAH 361)	302% (UAH 61)
Gas heating using 1000 m^3 per month (6 persons)	77.5% (UAH 471)	97% (UAH 40)
Average price increase	234% (UAH 146)	413% (UAH 48)
Overall price increase	255% (UAH 105)	

Source: own calculations based on the NERC decisions, Ukrstat and Naftogaz data

Despite possible overestimation of headline inflation, core inflation (that excludes raw food and regulated prices) reached 47.1% yoy, which is all-time high (core CPI was introduced in 2008). Monthly increase in core CPI was also very high at 4.6% mom, which is lower than in March and February, but higher than all other observations. The record inflation was primarily caused by drop in the hryvnia exchange rate from UAH 16 per USD in December to UAH 21-23 per USD in March and April after extreme fluctuations in February (exceeding UAH 30 per USD in some days) and related increase in energy prices. Insufficient competition in retail trade and economy in general as well as low energy efficiency added to supply-side pressure on prices. Difficulties in obtaining bank financing pushed companies to set prices more aggressively. At the same time, global commodity prices and labour costs remained contained. Oil prices were down by 45% yoy (IMF average in USD) and FAO food price index declined by 19% in April.

On the demand side, nominal household income grew slowly (average wage increased only by 13% yoy in March) and recent utility price increases mean that funds available for discretionary spending would be even tighter in the next months. Downward pressure on inflation will also reflect frozen minimum wage, pensions and public sector wages as well as slow growth of money aggregates.

As a result, increase in prices for household appliances (at 59% yoy) was comparable to increase in food prices (at 54% yoy) despite higher impact of exchange rate on costs for the former. Low demand had more pronounced impact on prices for services where price increases were mostly below 30% yoy (or close to zero in case of internet and mobile communications services) and prices for clothing (with relatively high gross retail margins in previous years).

In May, monthly core inflation may slow down further, but it will likely remain elevated at 2-3% mom. This will reflect delayed effects of hryvnia depreciation and increased inflation expectations. In the next months, the key domestic risk to price stability is inflation inertia, where higher prices feed into higher wages and social payments through indexation and they in turn lead to higher prices, or retailers and producers simply begin to expect to be able to increase their prices every month by few percent and this becomes self-fulfilling prophecy. However, several more months of relatively stable exchange rate may reduce inflation expectations. Labour market is unlikely to strengthen any time soon and wage increases will likely remain slower than inflation. Finally, social standards are set to increase only in December and fiscal restraint is one of the key conditions for the IMF program with Ukraine. In all, there is a good chance that Ukraine will be able to avoid inflation spiral and that inflation will slow down to below 15% in 2016.

[1] If we disregard extra accommodations (7 month heating season and lower imputed gas consumption) introduced by the government we reach 283% in gas tariff

Still, there are plenty of risks. On external side, there may be new pressure on the exchange rate or rising oil prices. On domestic side, social policy may become more populistic or political infighting may delay or disrupt cooperation with international donors. If these risks would result in another wave of hryvnia depreciation inflation would become even higher and it will be harder to bring it under control. This means that good performance of reform program and stabilization of exchange rate are critical for macroeconomic stability.

Monthly Economic Monitor Ukraine

Politics: Ukraine failed to get a new Marshall plan

Foreign aid. On April 28, representatives of developed countries' governments and international investors gathered in Kyiv for a long-awaited conference to discuss support of reforms in Ukraine. The conference was initiated in July 2014 by a group of international donors and creditors led by the European Union. The conference was intended to coordinate financial and technical assistance to meet Ukraine's Economic Recovery and Growth Agenda, aimed at supporting reconstruction of war-affected areas, economic stabilisation and growth recovery. The Agenda was considered as a possible basis for providing a large development aid to Ukraine, similar to the Marshall Plan after the World War II. However, at the conference Ukrainian government did not go beyond unveiling a USD 1.5 bn plan of recovery of the areas affected by the war in Donbas. The Government also presented opportunities to invest in agriculture and energy sector of Ukraine. Representatives of foreign governments and international investors welcomed the financial and humanitarian aid to Ukraine, but did not make any financial commitments. The modest results of the conference may be attributed to the slow pace of reforms in Ukraine and insufficient efforts by the Government in developing the Economic Recovery and Growth Agenda and securing aid.

Policies. In April, Ukraine's authorities made a few steps to reduce the red tape for business. On April 6, the President Petro Poroshenko signed the Law on Deregulation (No. 191-VIII), which amended 37 laws on regulation of business activities, and on procedures of public bodies. In particular, the Law abolished the requirement to obtain permits for a number of business operations, and enhanced protection of investors' rights.

On April 8, the Ministry of Justice launched an online service that enabled entrepreneurs to register businesses and obtain information from the business registry via the Internet. The Ministry of Justice became the first Ministry that started to provide its services on the Internet. This is a welcome step as it considerably simplifies interaction between the private sector and the Ministry.

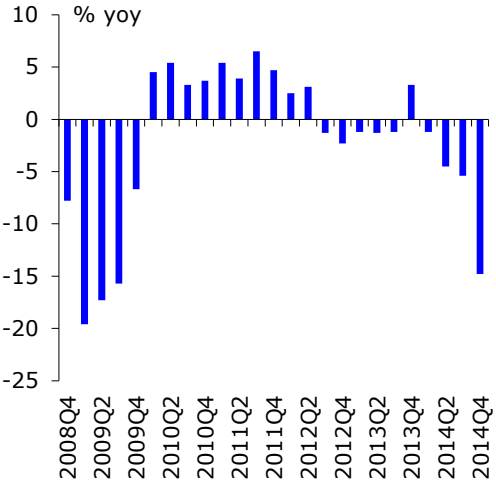
Top officials. On April 16, the President Petro Poroshenko established the National Anti-Corruption Bureau (NACB), responsible for fighting corruption among top-level officials. He appointed Artem Sytnyk as the Director of the NACB. This appointment followed an open and transparent competition for the position, carried out by a special committee made up of politicians and civil society activists. The committee selected and submitted two candidates to Mr. Poroshenko, one of those candidates was appointed. Such a way of selecting candidates for positions of top-level officials was novel to Ukraine. Mr. Sytnyk, 35 years old, previously was a partner in a law firm for about 4 years and worked in prosecutor's office for about 10 years.

On May 5, the Government appointed Roman Nasirov as the Head of the State Fiscal Service. This position was vacant since the resignation of Ihor Bilous in March. The appointment also followed an open competition. The special committee, made up of five officials and four representatives of business community, selected two candidates from the list of 67 applicants, and one of the two was appointed. Mr. Nasirov, 36 years old, previously was the Head of the Tax and Customs Policy Committee of the Parliament. Earlier he was deputy chairman of the board of the State Food and Grain Corporation and co-director of the Kyiv office of the Renaissance Capital investment company (Russia).

The war in the East. In April, low-intensity fighting went on in Donetsk and Luhansk oblasts. Pro-Russian insurgents and Russian troops kept on shelling and attacking Ukrainian troops despite the peace arrangement that was reached in February in Minsk. The total number of attacks from mid-February to the end of April exceeded

Population: 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

Institute for Economic Research
and Policy Consulting
Reytarska 8/5-A, 01034 Kyiv
Fax (+38044) 278-6336
E-mail: institute@ier.kiev.ua
http://www.ier.com.ua

2,500 (or about 35 per day). In that period, over 100 Ukrainian servicemen were killed and more than 500 were wounded. Ukrainian troops responded to the attacks. The front line did not change during the month. According to the United Nations, the conservative estimate of the total death toll from the conflict reached 6243 on May 3 (it was 6083 as of March 27). A new escalation of the conflict may be expected in the nearest months.

Real sector: The year of the crisis

The Ukrstat currently publishes data excluding temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol and the territory under anti-terroristic operation in the East. The statistical base was also revised to make like-to-like comparison available.

Sectoral trends. The industrial output in March contracted by 21.1% yoy due to protracted impact of military conflict in the East of Ukraine, weak external and domestic demand. The output in extractive industry in March decreased by 22.7% yoy. Production of coke and lignite dropped by 61.9% yoy as several mines were not able to operate in full capacity or terminated their operation.

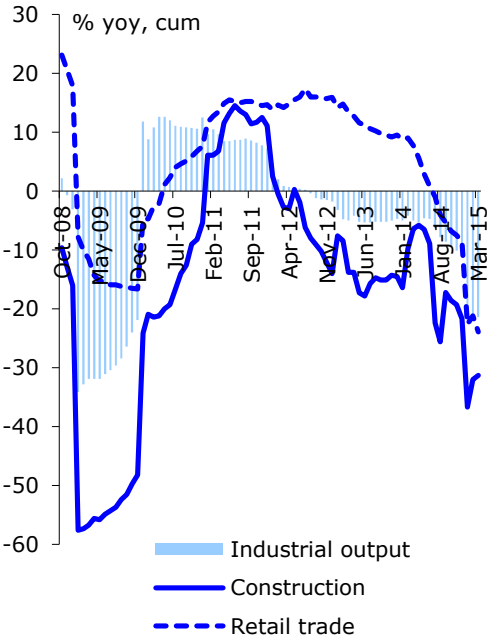
Manufacturing industry declined by 19.7% yoy due to decline in domestic demand and weak external demand as well as due to disruption of supply chain. The output in metallurgy decreased by 31.0% yoy, while the manufacture of chemical products dropped by 22.5% yoy as some companies of the industry faced restricted access to inputs. Lower domestic and external (primarily from Russia) demand resulted in contraction of machine building production by 22.7% yoy. In particular, production of vehicles dropped by 86.8% yoy due to decline in purchasing power of population. Absent demand from Russia resulted in decline in production of locomotives by 66.0% yoy. Food production (excluding tobacco and beverages) dropped by 13.4% primarily due to bans on imports of Ukrainian food products imposed by Russia as well as due to lower demand. At the same time, food production was supported by imports substitution.

Between January and March 2014 retail trade by enterprises dropped by 25.6% yoy, which reflects decline in real private final consumption. In particular, purchasing power of population declined due to lower real disposable income.

Freight turnover dropped by 21.5% yoy primarily due to logistic problems caused by military conflict and reduction of economic activity. Gas transit dropped primarily due to the opening of the Nord Stream pipeline that bypasses Ukraine.

Between January and March construction dropped by 31.3% yoy due to military conflict, financial constraints faced by companies and high fiscal pressure.

Real sector trends



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

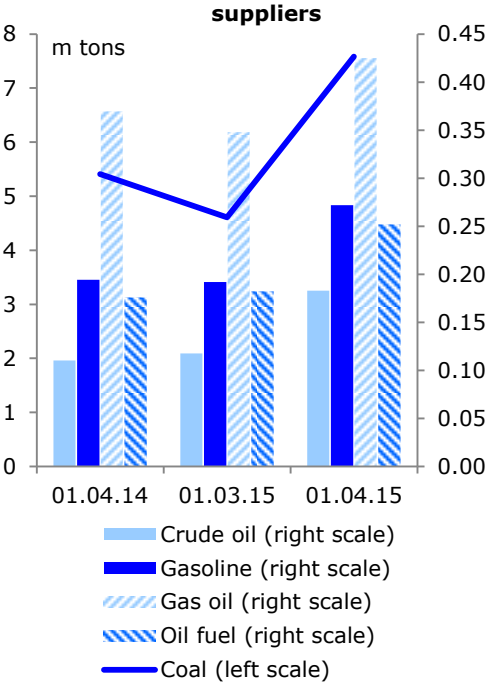
Energy sector: Beginning of gas marker reform

Gas. The Verkhovna Rada adopted a law *On the Natural Gas Market*, which finally stipulates expected for a long time gas market reform. The Law separates the functions of the gas system operators from gas extraction and supply, reinforces the independence of the regulator and introduces free price setting on the gas market. It is expected that under this law the gas market will become more transparent, competitive and attractive to investors. However, to make it work the Government will have to adopt a number of secondary legislation.

The Government continued increasing energy tariffs in the framework of energy reform. This step is aimed to decrease energy subsidies and introduce market prices at the energy markets. In April, gas tariffs for households were increased by 3.3 times to UAH 3600 per 1000 m^3 for the first 200 m^3 consumed per month and to UAH 7188 for consumption above that volume. From May 1 till September 30, the price of gas for households is UAH 7188 per 1000 m^3 regardless of the volume consumed. Also since May the National Commission for State Energy and Public Utilities Regulation (NERC) increased heating tariffs for the population by 72% to UAH 537.2 per GCal.

Electricity. The NERC increased the tariff for the Energoatom, national nuclear power generator, by 31.5% to UAH 0.4221 per

Fuel stock at consumers and suppliers



Source: Ukrstat

kWt*h. The change in tariffs reflects the necessity to finance modernisation of nuclear power plants and increased costs due to hryvnia depreciation.

In April, new electricity tariffs for households came into force. The tariff increased by 19% to UAH 0.366 per kWt*h for monthly consumption up to 100 kWt, by 50% to UAH 0.63 per kWt*h for consumption of 100-600 kWt and by 5% to UAH 1.407 per kWt*h for consumption above 600 kWt. This is the first stage of a five-stage tariff increase. Overall, the weighted average electricity tariff for households is planned to be increased by 3.5 times to UAH 1.2283 per kWt*h by April 2017.

Coal. During April, the stock of coal at thermal power stations of Ukraine decreased by 5% to 0.75 m tons (anthracite stock decreased by 25% to 0.2 m tons). Some thermal power stations, especially those that use anthracite coal, have stocks of coal that are sufficient for only a few days. For comparison, on April 1, 2014 there were 4.3 m tons of coal in stock. The stocks are much lower than on April 1, 2013, when there were 8.8 m tons in stock at consumers and suppliers (including coal in stock at mines and metallurgical plants), which may be partially explained by the overproduction of coal before.

Agriculture: End of growth period

Production. In March 2015 gross agricultural production declined by 6.8% yoy for the third month in a row. Overall, between January and March production decreased by 4.7% yoy as output dropped for both enterprises and households.

Sown area decreased by 35.5% yoy as of 1st of April due to early sowing campaign of 2014. If compared to 2011-2013 average, sown area doubled. Nevertheless, sown area decreased by 24.4% yoy for grain and leguminous cultures, by 87.7% yoy for sunflower, by 56.9% yoy for potatoes, and by 74.7% yoy sugar beets.

According to the Ukrstat, gross agricultural production costs in the first three months of the year increased by 66.3% yoy, while costs of material and technical resources used in agricultural production grew by 61.9% yoy. In the case of nitrogen fertilisers increase in prices might be partially explained by higher monopolization of the market due to smaller number of fertilisers' producers (two out of six plants stopped to operate), surged prices for natural gas as well as restricted access to gas. Increase in costs will negatively affect both seeding campaign and livestock production.

Between January and March 2015 number of cattle fell by 9.9% yoy and number of pigs reduced by 4.2% yoy. Production of meat reduced by only 2.0% yoy, and production of milk declined by 3.1% yoy. Decrease in the consumer demand and fall of purchasing prices of milk can lead to a substantial decline in the number of animals and consecutive deficit of domestic meat and milk.

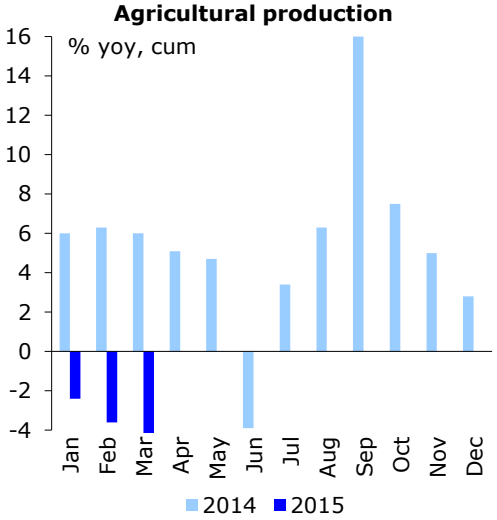
Agricultural policy. In April 2015 the European Commission adopted legislation that allows imports of eggs from Ukraine. As a result, two Ukrainian companies that already satisfy all EU requirements will be able to export eggs to EU already in 2015.

The Food and Veterinary Office of the European Commission published the report on the quality of milk production in Ukraine after European officials visited five Ukrainian companies. According to the report, three companies might be able to export their produce to the EU after some improvements. In particular, their production process is already satisfactory, but mechanism of milk segregation should be improved. This report is an intermediate step of including Ukraine to the list of countries that are allowed to export dairy products to the EU. Thus, most likely Ukrainian dairy products will reach European market not sooner than 2016.

External sector: Current account balance was balanced

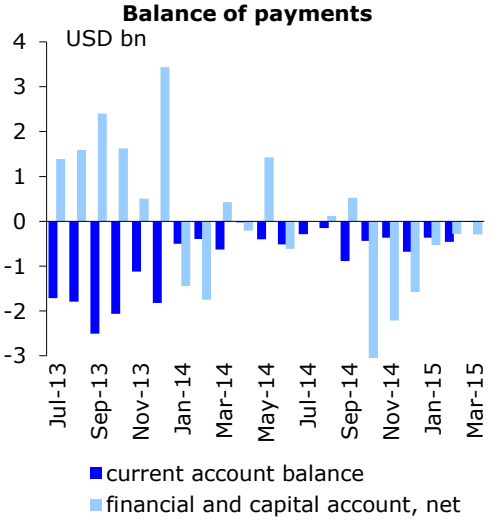
Current account in March was balanced mainly as merchandise trade deficit narrowed to USD 0.2 bn. Trade in services was in surplus at USD 0.1 bn.

Agricultural production



Source: Ukrstat

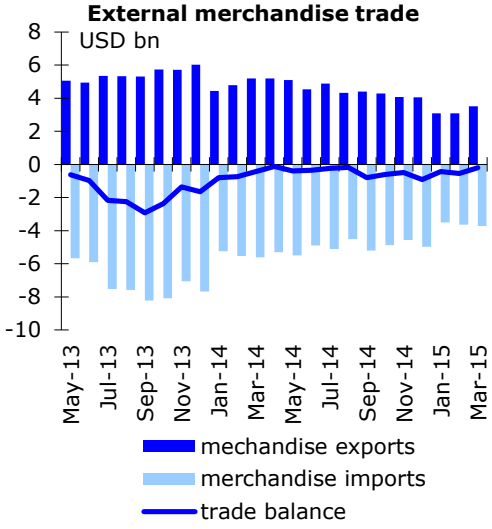
Balance of payments



Source: NBU preliminary estimates

Exports of goods dropped by 32.2% yoy due to disruption in production at occupied territories, weak external demand as well as trade tensions with Russia. Exports of minerals decreased by 56.7% yoy because of lower production as well as reallocation of sales to the domestic market. Machinery exports decreased by 48.7% as access to the Russian market remained restricted. Decline in exports of chemical products at 32.0% yoy is explained by termination of operations by several companies in occupied territories as well as in territories under control of Ukrainian government, more expensive imported inputs (in hryvnia equivalent), and restricted access to natural gas. Exports of metals decreased by 29.6% yoy because of termination of production at the occupied territories, logistics problems (including restricted access to raw inputs), and downward price trend at the world market. Exports of industrial goods decreased by 32.8% yoy because of weak external demand and more expensive hryvnia equivalent of imported inputs. Despite good harvest of most crops and autonomous trade preferences from the EU, exports of food products dropped by 19.4% yoy due to trade bans imposed by Russia and lower world prices. Exports of services contracted by 19.1% yoy because of smaller gas transit as well as lower outsourcing services.

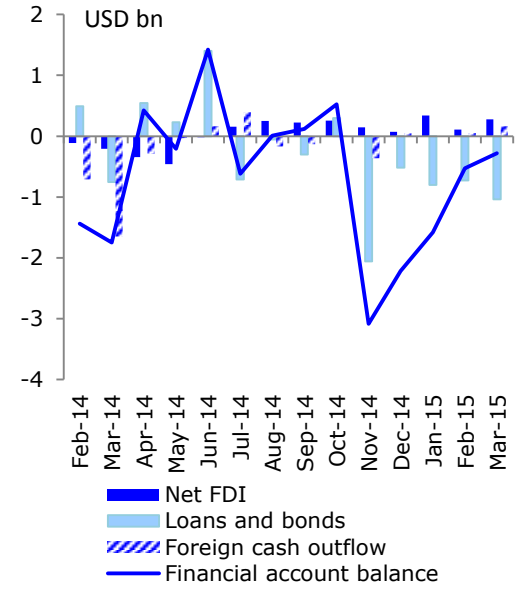
External merchandise trade



Source: NBU preliminary estimates

Imports of goods decreased by 33.9% yoy due to lower domestic demand. In particular, consumers' demand dropped due to imports substitution resulted from hryvnia depreciation (UAH 23.25 per USD in March 2015 vs. UAH 9.92 per USD in March 2014) and decline in purchasing power. As a result, imports of food decreased by 51.6% yoy. At the same time, economic and political uncertainty caused postponement of investment projects, which explain drop in imports of machinery by 40.4% yoy. Overall, imports of industrial products (including chemical products, wood, industrial goods, metals and machinery) decreased by 36.1% yoy. Imports of minerals decreased by 18.7% yoy because of smaller volume of purchased gas as well as its lower price. Imports of services decreased by 25.2% yoy due to decline in purchasing power and contraction of economic activity.

Financial account



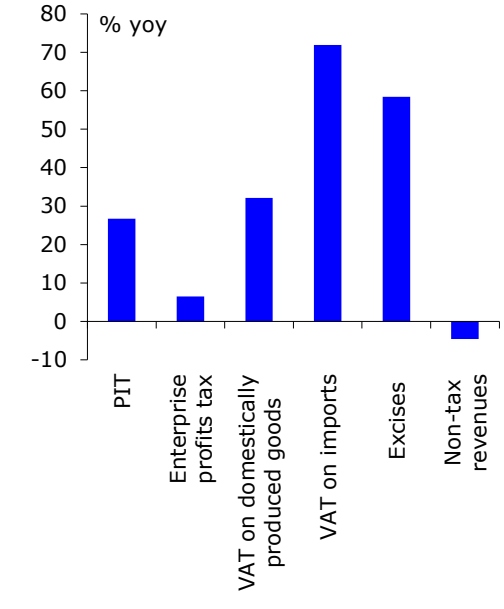
Source: NBU

Financial and capital account remained stable at USD 0.3 bn as higher surplus of capital account at USD 0.2 bn mitigated increase of financial account deficit to USD 0.5 bn. Net FDI inflow decreased to USD 0.1 bn and was directed mainly to the real sector. The deficit of bond and loan operations increased to USD 1.5 bn as banks and real sector had restricted access to external financing (deficit of USD 1.0 bn and USD 0.6 bn, respectively, was reported). Amount of foreign cash outside banks shrunk by USD 0.1 bn.

Fiscal policy: Surge in tax revenues

Budget Execution. Between January and March consolidated budget was in surplus of UAH 14.0 bn as compared to the deficit of UAH 0.5 bn in the same period of last year. Both central and local budgets were in surplus, while a year ago central fiscal deficit was equal to UAH 4.2 bn. Surplus this year is primarily explained by several factors. The Treasury reported receipts from sale of 3G licences (at UAH 6.1 bn in March) as a revenue item. Local government entities (LGEs) received higher than planned revenues due to changes in tax legislation as well as higher than expected inflation. At the same time, revision of spending upwards requires amending LGE budgets.

Growth of Consolidated fiscal revenues in January-March 2015



Source: State Treasury reports

Overall, growth of consolidated fiscal revenues in the first quarter of 2015 accelerated to 25.0% yoy as compared to growth of 9.7% in the first two months. In particular, consolidated fiscal revenues in March surged by 48.8% yoy due to acceleration of inflation, hryvnia depreciation, tax amendments, and receipts from 3G licences. Consolidated tax revenues grew by 61.2% yoy. VAT revenues from domestically produced goods increased by 82.4% due to higher inflation and larger sales of domestic goods due to sharp increase in demand for staple products (such as flour, sugar, etc.) against the background of high inflationary expectations. Increase in imports in hryvnia equivalent by 55% yoy in March and by 86% yoy in February (this includes tax-free gas imports and informal imports) resulted in growth of VAT on imported goods by 68.3% yoy. Excise revenues

doubled due to inflation, hryvnia depreciation, increase in excise rates, and changes in excise rules. Introduction of imports surcharge on most goods with the rate of 5-10% caused increase in revenues from international trade duties by 3.6 times. At the same time, non-tax revenues grew by 14.4% yoy as lack of transfer from the NBU was more than compensated by receipts from sale of 3G licences and higher own revenues of budget entities.

Still, the Government did not finance all its liabilities in time. In particular, central fiscal expenditures (general fund) remained by 9.0% of target. This is likely to be explained by usual delays in spending appropriated money at the beginning of the year. On the expenditure side the bright news is associated with the introduction of e-procurement for government entities for purchases below UAH 150 000, which might result in higher efficiency of fiscal expenditures.

Budget Amendments. Due to the lack of funds to pay wages at state coal mines the Government renewed partial compensation of the cost of coal. So, the Parliament approved state aid to coal mining sector at UAH 400 m. In the initial version of the State Budget Law for 2015 the Government allocated funds only for coal mine restructuring as it used the political window of opportunity to reduce enormous state aid to the inefficient state-owned mining companies. In particular, state aid to the sector accounted usually for near 1% of GDP. Provided financing is likely to help coal mines to pay wages timely, but might distort further reform of the sector.

Social policy: The pension reform is planned

The Government submitted to the Verkhovna Rada draft laws in the framework of promised pension reform. In particular, it suggests to cancel special pension to new retirees of specific groups (e.g. to civil servants, judges, prosecutors, people deputies) starting January 1, 2016. At the same time, existing special pensions will continue to be paid.

Besides, the Government suggests introducing the second pillar of the pension system – accumulative pension system – starting January 1, 2017. For this the State Accumulative Pension Fund is to be established. The participation in this pillar will be compulsory for individuals below 35 years old. The voluntary participation is planned to be available for individuals between 36 and 55 years old. The contribution to this pillar is to be defined at 2% of wage in 2017 and gradually increased to 7% of wage in 2022. The pension insurance contribution paid by employers will be reduced correspondingly.

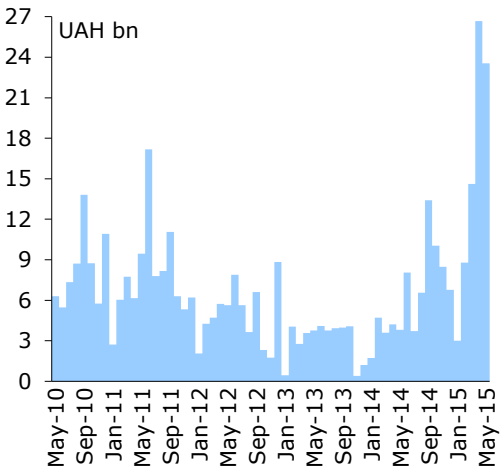
The introduction of the accumulative pension system was already envisaged in the pension reform approved 2003. It was first expected to be introduced in 2007 if balanced budget of the Pension Fund in the PAYG (pay-as-you-go) system is achieved. However, after rapid increase in pensions in 2004 and 2005 the Pension Fund had high deficit, which postponed introduction of the second pillar. The Pension Fund is unlikely to be balanced in 2017 and, thus, the Government decision will increase the deficit of the Pension Fund further (e.g. planned deficit for 2015 is UAH 19.0 bn) as contributions to the second pillar will be withdrawn from the first pillar. International experience suggests that introduction of the second pillar might be sustainable only if the PAYG system is sustainable. During recent economic crisis, the funds of the second pillar were nationalised in several countries where overall pension system was unsustainable. The Government expects that sources of the accumulative pension system will help in developing capital market in Ukraine. However, it will likely increase the risks for the pension system as outcomes of any investments of funds during economic and political instability are too uncertain.

Labour market: Real wage is still falling

Average wage in March grew by 13.1% yoy in nominal terms due to indexation of wages for inflation. However, due to sharp acceleration of inflation wages dropped by 24.6% yoy in real terms.

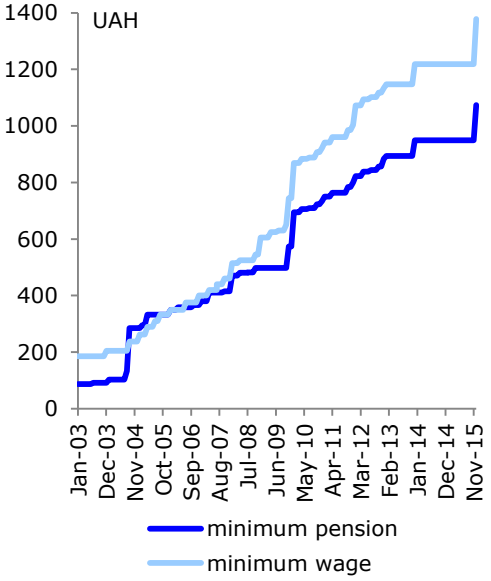
Average wage in the industry increased by 17.1% yoy in nominal terms. Particularly, wages increased by 10.3% yoy in the extractive

Balance of the Single Treasury Account



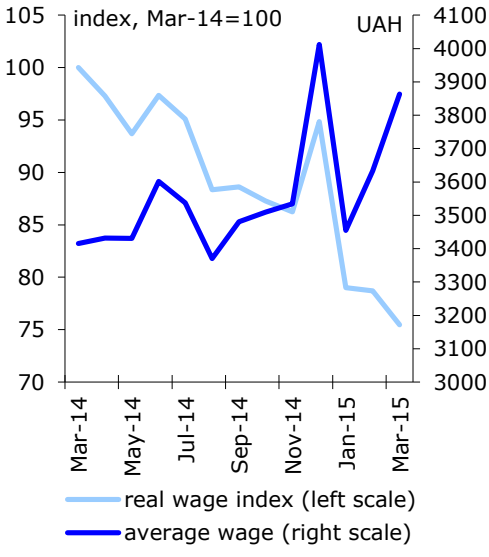
* in the beginning of month
Source: State Treasury

Social standards



Source: State Budget Laws for 2006-2015

Average wage*



*not including AR Crimea
Source: Ukrstat

industry and by 25.6% yoy in manufacturing likely due to the inflation indexation of wages. Unchanged minimum wage and negative financial results of the firms continued to put a downward pressure on a wage growth in the sector. Nevertheless, some domestically oriented sectors were able to benefit from the imports substitution. In particular, wages grew by 42.4% yoy in the pharmaceutical industry and by 33.6% yoy in textile industry. At the same time, export oriented sectors received increased revenues (in hryvnia equivalent) due to hryvnia depreciation, which likely explains increase in wages in metallurgy by 32.0% yoy. Wages in the production of computers, electronical and optical equipment surged by 35.0% yoy likely due to larger number of military contracts.

Wage in the agriculture increased by 19.6% yoy. Wage growth in the sector was constrained by the surge in prices for other inputs, e.g. petroleum and fertilisers, which are necessary for on-going sowing campaign.

As previously, wage growth in public sector was limited by previously approved decisions to reduce bonuses and premiums and cuts in basic wages.

Monetary policy: Another record for inflation

In April, consumer prices reportedly increased by 14% mom and by 33% between February and April. Record inflation figure reflects one-off revision in gas and electricity prices for households (by 5.5 times and 33% respectively) that increased CPI by around 10%. We believe gas price in fact increased by 3.5 times on average and monthly CPI increase should have been around 10%. Moreover, expansion of utility subsidies may further limit increase in gas bill for households.

Still, monthly core inflation was also high at 4.6% mom. High core inflation reflected both delayed effects of exchange rate instability and high inflation expectations despite two months of relatively stable exchange rate. Wide-based price increases were observed for most goods and services at 3-5% mom but some commoditized goods became cheaper including eggs, sugar and gasoline.

The NBU kept policy rate at 30% p.a. and deposit rates at 20-27% p.a. in April. This kept interbank and lending interest rates at high nominal levels and free liquidity low.

Exchange rate: Band goes on

In April, the NBU maintained the exchange rate band but revised its bounds from UAH 21.5-23.5 per USD to UAH 21-23 on April 16. Administrative restrictions and stabilization of the market allowed the NBU to support the band. As hryvnia strengthened in the second half of April the NBU purchased more foreign currency than sold on the open market. Stability remained fragile but cash and grey market exchange rate moved closer to interbank exchange rate.

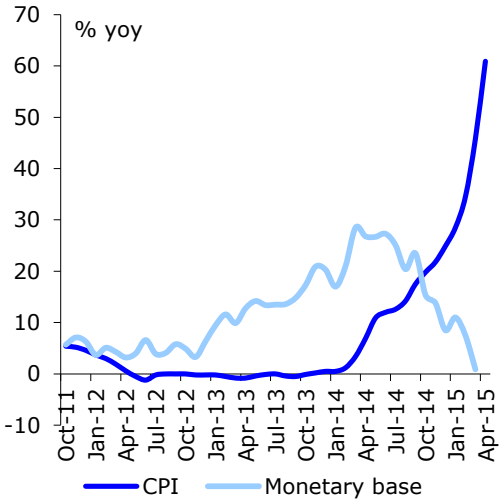
Peak redemptions and interest payments on foreign currency bond led Ukraine's international reserves to decrease to USD 9.6 bn by the end of April.

State debt: More support from the EU

External debt. In April, the EU disbursed to Ukraine a final tranche of EUR 250 m (out of total EUR 1.6 bn) under two previous packages of macro-financial assistance (MFA). MFA is aimed at supporting structural reforms to ensure sustainable economic growth and sound financial situation. The third MFA programme of EUR 1.8 bn was approved in late March 2015 and is to be implemented within two years. In particular, the Government expects to receive EUR 1.2 bn in 2015 and EUR 0.6 bn in 2016.

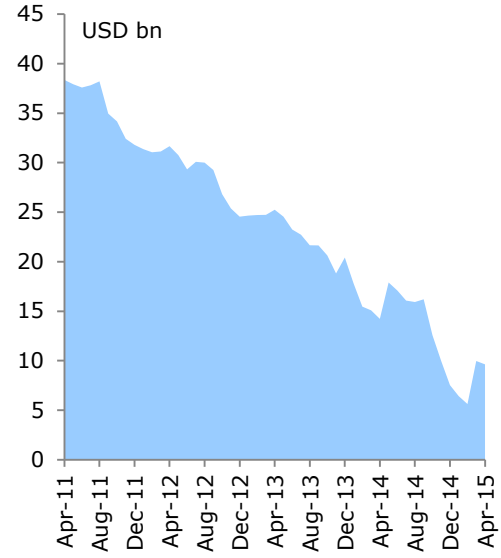
Domestic debt. In April, the Ministry of Finance placed only UAH 164 000 of short-term 'military' domestic bonds with weighted average yield at 7.0%. The Government did not offer regular state domestic bonds likely due to low demand.

CPI and monetary base development



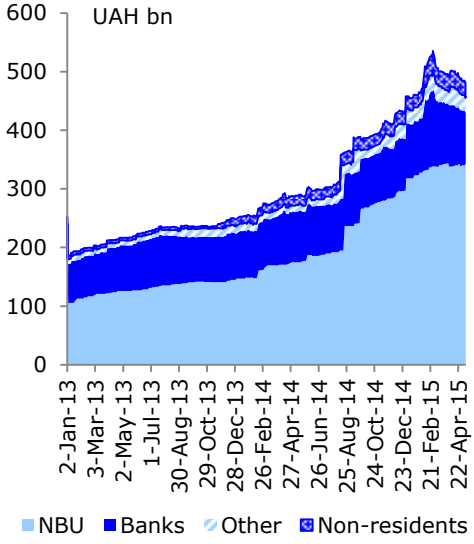
Source: Ukrstat, NBU

NBU international reserves



Source: NBU

Domestic government bond holdings



Source: NBU

Tables

		Q2 13	Q3 13	Q4 13	Q1 14	Q2 14	Q3 14	Q4 14	May[c]	Jun[c]	Jul[c]	Aug[c]	Sep[c]	Oct[c]	Nov[c]	Dec[c]	Jan[c]	Feb[c]	Mar[c]	Apr[c]
Industrial production (real)	% yoy cum.	-5.3	-5.2	-4.7	-5.0	-4.7	-8.6	-10.7	-4.6	-4.7	-5.8	-7.8	-8.6	-9.4	-10.1	-10.7	-21.3	-21.7	-21.4	…
Construction (real)	% yoy cum.	-17.8	-15.1	-14.5	-6.4	-8.9	-17.2	-21.7	-6.5	-8.9	-22.4	-4.0	-17.2	-18.6	-19.3	-21.7	-36.7	-32.0	-31.3	…
Agricultural production (real)	% yoy cum.	15.4	3.0	13.7	6.0	-3.9	16.0	2.8	4.7	-3.9	3.4	6.3	16.0	7.5	5.0	2.8	-2.4	-3.6	-4.7	…
Retail trade turnover (real)	% yoy cum.	11.2	9.8	9.5	7.7	0.8	-5.3	-8.6	2.9	0.8	-1.0	-4.0	-5.3	-6.8	-7.5	-8.6	-22.6	-21.2	-23.9	…
Average wage	UAH	3289	3331	3390	3245	3488	3463	3685	3430	3601	3537	3370	3481	3509	3534	4012	3455	3633	3863	…
CPI	% yoy eop	-0.1	-0.5	0.5	3.4	12.0	17.5	24.9	10.9	12.0	12.6	14.2	17.5	19.8	21.8	24.9	28.5	34.5	45.8	60.9
PPI	% yoy eop	-1.6	-0.9	1.7	3.9	15.9	26.9	31.8	8.8	15.9	22.5	24.2	26.9	25.9	32.8	31.8	34.1	41.0	51.7	48.6
Exports (USD)*	% yoy cum.	-7.1	-6.2	-5.2	-7.7	-6.5	-9.1	-14.4	-6.4	-6.7	-6.8	-8.2	-9.1	-10.8	-12.6	-14.4	-30.7	-34.1	-32.9	…
Imports (USD)*	% yoy cum.	-8.3	-4.1	-3.4	-14.7	-18.6	-24.8	-27.4	-17.3	-17.3	-19.5	-22.4	-24.8	-26.3	-26.7	-27.4	-33.0	-32.9	-33.7	…
Merchandise trade balance	USD bn cum.	-7.1	-14.2	-19.6	-1.9	-0.6	-3.6	-6.1	-2.2	-2.5	-2.7	-3.0	-3.6	-4.2	-5.1	-6.1	-0.4	-0.6	-1.2	…
Current account**	USD bn cum.	-5.5	-11.4	-16.4	-1.3	-0.6	-3.3	-5.2	-1.5	-1.9	-2.3	-2.7	-3.3	-4.0	-4.5	-5.2	-0.3	-0.4	-0.8	…
Gross international reserves	USD bn eop	23.2	21.6	20.4	15.1	17.1	16.4	7.5	17.9	17.1	16.1	15.9	16.4	12.6	10.0	7.5	6.4	5.6	10.0	9.6
Monetary Base	% yoy eop	13.4	14.8	20.3	28.5	25.1	23.5	8.5	26.7	27.3	25.1	20.4	23.5	15.4	13.8	8.5	11.0	7.5	0.9	…
Lending rate on UAH credits	% pa, aop	15.4	15.3	16.5	18.5	17.5	16.4	16.6	17.9	17.2	16.1	16.8	16.2	16.3	16.7	16.9	17.2	18.8	23.7	…
Exchange rate (interbank)	USD aop	8.14	8.15	8.21	9.1	11.71	12.58	14.44	11.78	11.79	11.74	12.98	13.01	12.93	14.75	15.63	15.94	24.77	22.98	22.49
Exchange rate (official)	USD aop	7.99	7.99	7.99	8.9	12.71	12.58	14.42	11.64	11.81	11.76	12.95	13.02	12.95	14.70	15.62	15.81	24.48	23.26	22.71
Exchange rate (official)	EUR aop	10.44	10.58	10.87	12.14	13.71	16.67	18.02	16.00	16.04	15.93	17.25	16.83	16.43	18.36	19.26	18.53	27.78	25.32	24.47

Sources: Ukrstat, NBU, ICAP, own calculations

* Monthly figures are only for merchandise exports and imports (source: NBU, preliminary data)
Quarterly figures are for trade in goods and services (source: NBU)

** Monthly data are according to the preliminary estimates provided by the NBU

[c] Data excludes Crimea. Since 2015 the Ukrstat also does not include data for occupied territories in the East of Ukraine

Key Economic Indicators		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014[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	1082.6	1302.1	1408.9	1454.9	1566.7
Nominal GDP	USD bn	31.3	38.0	42.4	50.1	64.9	86.2	107.8	142.7	179.9	117.2	136.4	163.4	176.3	182.0	132.0
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	5.2	0.3	0.0	-6.8
Industrial production	% yoy	13.2	14.2	7.0	15.8	12.5	3.1	6.2	10.2	-3.1	-21.9	11.2	7.3	-0.5	-4.7	-10.7
Agricultural production	% yoy	9.8	10.2	1.2	-11.0	19.7	-0.1	0.4	-5.2	17.5	0.1	-1.0	17.5	-4.5	13.7	2.8
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
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
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
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
Exports (gs, USD)	% yoy	17.9	9.5	10.7	24.0	42.6	7.5	13.2	27.5	33.8	-36.7	27.1	28.2	1.0	-5.2	-0.2
Imports (gs, USD)	% yoy	18.9	14.1	4.9	28.7	31.3	20.4	22.0	35.5	38.6	-43.1	29.3	33.8	5.6	-3.4	-0.3
Current account	USD bn	1.5	1.4	3.1	2.9	6.9	2.5	-1.6	-5.3	-12.9	-1.9	-2.9	-9.3	-14.3	-16.4	-5.3
Current account	% GDP	4.7	3.7	7.6	5.9	10.6	2.9	-1.5	-3.7	-7.2	-1.7	-1.7	-5.7	-8.1	-9.0	-4.0
FDI (net)	USD bn	0.6	0.8	0.7	1.4	1.7	6.5	5.3	9.2	9.9	4.5	5.7	6.6	6.6	3.4	0.3
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
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
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	39.9	36.0	37.4	39.9	70.2
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	22.0	20.6	39.0
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
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
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
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
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

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

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

[c] Data excludes Crimea

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		Q4 09	Q1 10	Q2 10	Q1 11	Q2 11	Q3 11	Q4 11	Q1 12	Q2 12	Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14[c]	Q2 14[c]	Q3 14[c]	Q4 14[c]
GDP	UAH bn	259.9	217.3	256.8	257.7	311.0	369.8	363.6	293.5	349.2	387.6	378.6	302.9	353.0	394.7	404.3	313.6	375.9	434.2	443.1
GDP (real)	% yoy	-6.7	4.5	5.4	5.1	3.9	6.5	5.0	2.5	3.1	-1.3	-2.3	-1.2	-1.3	-1.2	3.3	-1.2	-4.5	-5.4	-14.8
Household consumption (real)	% yoy	-16.2	0.2	6.8	13.2	14.2	16.1	18.5	7.8	12.3	11.0	5.5	6.5	9.5	8.4	6.8	2.2	-9.0	-15.5	-13.6
State consumption (real)	% yoy	-3.7	3.8	-4.0	2.0	2.9	-9.4	-6.6	3.3	4.8	9.9	1.5	1.1	-2.3	-3.3	-2.5	-6.0	4.5	-0.5	3.5
Gross fixed capital formation (real)	% yoy	-33.7	-5.7	-3.2	-1.8	3.7	9.7	12.0	13.8	17.5	-5.2	-4.9	7.0	-17.4	-7.7	-5.1	-19.9	-16.8	-26.7	-26.2
Exports of goods and services (real)	% yoy	6.9	0.4	13.2	19.4	4.9	0.3	-4.1	-7.3	-8.1	-3.8	-9.6	-9.0	-14.3	-7.9	-4.1	-5.8	-2.6	-16.8	-31.0
Imports of goods and services (real)	% yoy	-11.1	-6.2	17.2	38.1	23.3	12.5	5.2	-3.0	9.0	4.3	-2.6	-2.4	-18.4	-0.7	-1.8	-13.0	-11.1	-31.9	-29.0
Agriculture, hunting, forestry (real)*	% yoy	-11.6	5.4	0.5	4.9	1.3	16.7	38.1	0.5	11.5	-8.3	-4.0	5.7	20.8	-2.0	38.2	5.9	-9.0	25.7	-19.1
Manufacturing industry (real)*	% yoy	6.5	10.9	10.1	7.8	3.4	4.6	-2.9	1.1	1.8	-4.8	-5.5	-9.5	-9.2	-9.8	-8.9	-8.8	-8.0	-14.8	-16.7
Construction (real)*	% yoy	-32.8	-7.7	-5.8	1.7	10.9	0.1	2.0	1.2	3.4	-15.3	-20.8	-14.9	-20.8	-11.1	-7.7	4.4	-16.7	-24.1	-30.9
Trade, repair services (real)*	% yoy	-16.4	6.1	9.6	9.8	2.8	6.1	3.0	3.2	4.6	0.4	-1.2	1.6	-0.2	1.9	4.7	-3.2	-8.2	-17.5	-21.7
Transport (real)*	% yoy	-0.4	1.3	1.8	10.2	7.9	5.7	11.1	-2.3	-3.3	-8.4	-9.5	-2.7	-0.6	2.8	2.8	-2.3	-5.9	-5.6	-12.1
Balance of payments																				
Current account balance	USD bn	-0.9	0.0	0.5	-1.6	-1.7	-2.6	-4.4	-2.1	-3.8	-4.0	-4.9	-3.1	-2.3	-6.0	-4.9	-1.5	-0.9	-1.3	-1.5
Current account balance	% of GDP	-2.7	-0.1	1.6	-4.9	-4.4	-5.6	-9.5	-5.6	-8.7	-8.3	-10.3	-8.3	-5.1	-12.2	-9.8	-4.3	-3.2	-3.8	-4.8
Trade balance in goods	USD m	-1407	-1236	-697	-3597	-2851	-4580	-5224	-3867	-5577	-5215	-5833	-4045	-3053	-7232	-5268	-1956	-869	-1216	-2024
Trade balance in services	USD m	550	930	1115	1262	1514	2007	1312	1299	1362	1975	1084	822	893	1919	480	444	-55	89	304
Current transfers	USD m	722	608	728	1039	878	988	803	683	805	777	711	533	589	480	547	241	494	306	500
Direct investment (FDI)	USD m	1282	923	1196	880	2422	2090	1623	1663	1091	2002	1871	821	472	1199	859	-665	-319	725	558
Portfolio investments (equity)	USD m	41	-20	-18	149	113	42	207	-3	74	83	339	705	579	664	-757	-239	-50	-84	-17
Gross international reserves	USD bn	26.5	25.1	29.5	36.4	37.6	35.0	31.8	31.1	29.3	29.3	24.5	24.7	23.2	21.6	20.4	15.1	17.1	16.4	7.5
Exchange rate (interbank), UAH/USD	aop	8.06	8.00	7.91	7.95	7.98	7.99	8.01	8.03	8.04	8.09	8.11	8.11	8.14	8.15	8.21	9.14	11.71	12.58	14.44
Exchange rate (official), UAH/USD	aop	7.99	7.99	7.91	7.94	7.97	7.97	7.98	7.99	7.99	7.99	7.99	7.99	7.99	7.99	7.99	8.86	12.71	12.58	14.42
Fiscal indicators																				
Consolidated fiscal revenues	% of GDP	36.0	30.9	30.4	32.8	30.0	29.5	30.7	33.6	31.6	28.2	33.7	35.3	29.5	29.1	28.9	35.8	29.9	29.0	32.6
Personal income tax	% of GDP	4.7	4.9	4.8	5.0	4.8	4.2	4.7	5.1	4.9	4.4	5.0	5.3	5.1	4.7	4.9	5.2	4.8	5.0	6.0
Enterprise profits tax	% of GDP	3.6	4.3	3.0	4.5	4.5	3.6	4.4	4.9	4.1	2.9	4.2	6.2	3.4	3.0	3.0	5.0	2.5	2.2	1.8
Value-added tax	% of GDP	11.0	9.8	9.8	7.6	12.9	9.6	9.6	10.8	10.3	8.6	10.0	9.7	9.1	8.2	8.5	8.8	9.7	8.0	12.0
Excise tax	% of GDP	2.6	2.4	3.0	2.1	3.0	2.7	2.4	2.8	2.9	2.8	2.4	3.1	2.6	2.3	2.2	2.5	3.0	3.6	3.3
Consolidated fiscal expenditures	% of GDP	34.5	33.0	38.7	32.8	33.1	26.9	35.6	33.7	33.8	30.7	41.4	37.0	36.0	30.4	36.3	35.6	35.3	31.9	42.3
Current expenditures	% of GDP	31.4	32.4	37.4	31.5	30.8	23.9	30.1	31.8	31.3	27.7	37.4	35.7	34.1	28.5	33.5	35.1	34.3	30.2	40.0
Capital expenditures	% of GDP	3.1	0.6	1.4	1.3	2.4	3.0	5.5	1.9	2.4	2.9	4.0	1.3	1.9	1.9	2.8	0.5	1.0	1.7	2.3
Consolidated fiscal balance	% of GDP	1.1	-2.0	-8.0	-0.3	-3.4	-3.9	-5.5	-0.2	-2.6	-3.0	-7.8	-1.9	-6.3	-1.5	-7.4	0.1	-5.4	-3.2	27.9
Privatisation receipts	% of GDP	0.0	0.1	0.0	0.4	3.2	0.0	0.1	1.4	0.3	0.1	0.4	0.0	0.0	0.2	0.1	0.0	0.0	0.0	0.1
Labour market																				
Average wage (real)	% yoy	-5.7	3.3	8.7	11.1	5.5	7.7	10.8	14.7	16.5	13.3	12.9	9.9	9.3	8.1	5.9	3.5	-4.1	-11.0	-13.4
Household income (real)	% yoy	-7.6	3.7	11.8	7.8	1.9	7.3	7.7	6.0	13.0	10.4	9.4	8.9	5.7	2.5	4.7	-3.4	-6.8	-5.6	-19.2
Unemployment rate (ILO methodology)	% cum	9.4	9.0	7.9	8.7	7.7	6.9	8.2	8.4	7.1	6.6	8.0	8.0	7.5	7.0	7.6	9.0	8.2	9.5	10.6
Banking system																				
Monetary aggregate M0	% yoy cum	1.5	5.4	9.9	15.7	11.5	8.6	6.3	4.7	6.7	5.2	5.5	9.7	9.8	12.3	17.0	19.2	31.9	28.8	19.0
Monetary aggregate M2	% yoy cum	-5.4	6.9	13.2	25.5	22.0	16.0	14.4	11.2	9.0	10.7	13.1	16.0	17.9	19.2	17.5	17.7	13.4	14.2	5.4
Household deposits in national currency	% yoy cum	-8.5	7.1	20.1	43.3	26.0	16.7	12.3	14.4	16.4	16.3	16.3	19.1	26.5	33.4	38.0	7.9	-2.3	-12.3	-22.1
Household deposits in foreign currency	% yoy cum	4.7	22.8	21.5	19.7	21.0	15.7	13.4	12.4	10.8	17.0	21.8	17.0	14.7	8.4	0.9	19.8	10.2	5.5	18.0
Com. bank credits in national currency	% yoy cum	16.9	13.6	8.3	16.0	18.5	21.1	21.0	17.4	15.3	9.1	7.7	8.6	7.4	10.2	16.9	12.3	4.9	-0.8	-9.1
Com. bank credits in foreign currency	% yoy cum	-15.2	-13.7	-10.5	-2.1	0.9	-2.3	-4.2	-7.0	-10.8	-9.9	-7.3	-4.4	-0.4	0.8	2.8	36.4	38.5	49.1	53.5
Long-term com. bank credits	% yoy cum	-3.8	-3.9	-2.8	5.0	6.3	5.3	2.9	-2.9	-7.0	-8.0	-6.6	-5.6	-2.7	-0.5	2.9	26.3	24.4	24.6	21.7
Long-term com. bank credits	% of total	68.1	68.5	68.9	67.2	66.6	64.4	62.9	61.5	59.8	59.1	57.8	55.9	55.7	55.1	53.2	58.5	59.1	59.8	59.5
Average lending rate on national currency credits	% p.a.	19.8	17.3	15.0	13.1	13.5	14.1	18.4	15.5	15.6	19.5	20.8	16.2	15.3	15.3	16.5	18.4	17.5	16.4	16.6
Average lending rate on foreign currency credits	% p.a.	10.1	10.9	11.1	10.2	9.8	8.8	8.4	8.2	8.2	8.5	8.8	9.4	9.7	9.6	8.8	8.7	9.4	9.2	8.8

Sources: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, Reuters, IER estimates
* change in value added
[c] Data excludes Crimea, preliminary NBU estimates for balance of paymer

Contact information:

Institute for Economic Research
and Policy Consulting
Reytarska St. 8/5-A, 01030 Kyiv
Tel. (+38044) 278-6342
Fax (+38044) 278-6336
E-mail: institute@ier.kiev.ua
http://www.ier.com.ua

Head of the Board-Director

Igor Burakovsky
burakovsky@ier.kiev.ua

Chief Executive

Oksana Kuziakiv
kuziakiv@ier.kiev.ua

Academic Director

Veronika Movchan
movchan@ier.kiev.ua

Centre for Economic Studies

Oleksandra Betliy
betliy@ier.kiev.ua

Vitaliy Kravchuk
Kravchyk@ier.kiev.ua

Iryna Kosse
kosse@ier.kiev.ua

Kateryna Furmanets
furmanets@ier.kiev.ua

Artur Kovalchuk
kovalchuk@ier.kiev.ua

Dmytro Naumenko
naumenko@ier.kiev.ua

Mykola Ryzhenkov
ryzhenkov@ier.kiev.ua

Kostiantyn Kravchuk
k.kravchuk@ier.kiev.ua

Oleksa Stepaniuk
stepaniuk@ier.kiev.ua

Victor Grechyn
grechyn@ier.kiev.ua

Center for Contemporary Society Studies

Iryna Fedets
fedets@ier.kiev.ua

Tetiana Oliinyk
oliinyk@ier.kiev.ua

German-Ukrainian Agricultural Policy Dialogue

Yuliya Ogarenko
ogarenko@ier.kiev.ua

Mariya Yaroshko
yaroshko@apd-ukraine.de

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