Year 2014: Economic Summary for Ukraine

A year of crisis and new opportunities

EXECUTIVE SUMMARY

In 2014, Ukraine faced the toughest challenges in the XXI century including economic crisis, military conflict in the East, and annexation of Crimea by Russia. Drop in domestic demand and weak external demand resulted in contraction of real GDP by 6.8%. High economic and political uncertainty resulted in sharp increase in demand for foreign currency. This along with decline in exports lead to sharp hryvnia depreciation. Throughout the year the Government faced tough fiscal choices as more spending for defence and security was needed at time of restricted revenues, which required the Government to revise the Budget Law and taxation legislation. Despite IMF Program new Ukrainian authorities were slow in implementing reforms required to ensure economic growth in the medium term. Still, the Association Agreement with the EU was finally signed in 2014 and it defines reform commitments of Ukraine for the future.

Politics. Mass civil unrest led to ouster of President Yanukovych and a geopolitical reorientation towards Europe. This triggered an abrupt reaction from Russia, which annexed Ukrainian peninsula of Crimea and stoked a ferocious war in Donbas, disrupting large part of Ukraine's economy.

Real Sector. Real GDP dropped by 6.8%. Real gross value added declined in all sectors, except for agriculture and nonmarket services, due to conflict in the Eastern Ukraine. High fiscal pressure, financial constraints and accelerated inflation led to contraction of domestic demand by 10.8%. Net real exports positively contributed to economic growth as real imports dropped more than real exports.

Agriculture. Agricultural production increased by 2.8% due to good crop harvest and increase in livestock production. At the same time, food exports dropped by 11.5% as Russia imposed bans on a number of food products from Ukraine.

Energy policy. Ukraine reduced sharply purchases of natural gas from Russia due to increased reverse gas supplies from Europe and contracted overall gas consumption. The Government also had to deal with massive energy deficit due to loss of coal production, limited gas supplies and electricity grid imbalances. The year was mostly marked by protracted conflict between the Naftogaz and Russian Gasprom.

Infrastructure. The Government increased housing and utility tariffs as well as rail freight and passenger tariffs. Spending to maintain the infrastructure declined sharply. However, no substantial reforms in infrastructural sectors were delivered.

Balance of Payments. Balance of payments deficit surged to USD 13.3 bn or 10.1% of GDP due to negative financial account balance. As a result, NBU international reserves dropped to USD 7.5 bn by the end of 2014 as compared to USD 20.4 bn in the end of 2013. At the same time, hryvnia depreciation led current account deficit to shrink to USD 5.3 bn or 4.0% of GDP.

Income: Real disposable income dropped by 8.4% due to high inflation, difficult financial situation of companies, and frozen social standards.

Fiscal policy. Fiscal policy was a core priority of the IMF Program and government reform agenda. The Government increased taxes and tried to contain spending as revenues were restricted due to recession. Fiscal deficit, recapitalisation of state-owned banks and the Naftogaz as well as sharp hryvnia depreciation led to surge of state debt to 70.3% of GDP.

Monetary policy and financial sector. Huge size of quasi-fiscal operations with government bonds, disruption of interbank credit market due to bank failures, limit on bank refinancing outside of rescue policy limited role of monetary policy. In December 2014, CPI surged by 24.9% yoy as hryvnia lost half its value vs. US dollar. Financial sector remained functioning but a lot of companies left the market.

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Politics: Ukraine's turn to Europe triggered a war with Russia

In 2014, Ukraine underwent the biggest upheaval in the decades following the World War II. The country saw mass civil unrest that led to a power shift and a geopolitical reorientation towards Europe. This triggered an abrupt reaction from Russia, which annexed Ukrainian peninsula of Crimea and stoked a ferocious war in Donbas, disrupting large part of Ukraine's economy.

Power shifts. From the point of view of domestic politics, the year had three main outcomes. First, pro-European forces came to power in Ukraine. This was a result of the mass anti-presidential protests that started in November 2013 and were known as Euromaidan. On February 18-20, President Viktor Yanukovych made an attempt to violently put down the protests. After the attempt failed, he left Kyiv and found shelter in Russia. On February 22, opposition leader Oleksandr Turchynov was elected as the Speaker of the Parliament and became the Acting President of Ukraine. Three opposition parties (Batkivshchyna, Udar, and Svoboda) formed a new pro-European government led by Arseniy Yatsenyuk.

Second, Ukraine changed its system of government. On February 22, the Parliament voted for a return to the Constitution of 2004, abandoning a presidential system of government and pushing the balance of power in favour of a parliamentary system.

Third, the new authorities demonstrated commitment to democracy by holding two fair and competitive elections. On May 25, Petro Poroshenko, a billionaire and a centrist politician, who supported Euromaidan, was elected the President of Ukraine. On October 26, Ukrainians also elected a new Parliament, in which a majority of seats went to five parties that supported European integration of Ukraine (Petro Poroshenko Bloc, People's Front, Samopomich, Batkivshchyna, and the Radical party). The coalition included a constitutional majority of the members of the Parliament (302 out of 422 elected MP's). The Communist party did not get seats in Parliament for the first time since the independence of Ukraine. The Party of Regions, which was the ruling party until February 2014, did not participate in the election. Former allies of Viktor Yanukovych were elected to Parliament as members of the Opposition Bloc, which got 40 seats (the Party of Regions had 210 seats in parliament in November 2013). On December 2, the ruling coalition formed a new semi-technocratic government, in which Arseniy Yatsenyuk retained the post of the Prime Minister. The coalition gave almost all positions of the ministers responsible for economic policy to professionals that were not politically affiliated, mostly to investment bankers. In particular, three of ministerial seats were given to foreign nationals (the Ministry of Finance, the Ministry of Economic Development and Trade, and the Ministry of Healthcare).

The EU. After the first change of government Ukraine concluded the long-awaited Association agreement (AA) with the European Union (EU). This happened in two stages: several chapters of the agreement were signed in March, and the most important part of the document was concluded in June. The entry of the AA into force was also split into several phases. The sections covering political cooperation became effective on November 1, but the establishment of a deep and comprehensive free trade area (DCFTA) between Ukraine and the EU was postponed until January 1, 2016 because of pressure from Russia. However, the EU partially offset the deferment by granting autonomous trade preferences to Ukraine (see *Trade policy*).

In 2015, Ukraine also made a few steps towards getting a visa-free regime for short trips between Ukraine and the EU. In May, Ukraine completed the first phase of the EU-Ukraine Visa Liberalisation Action Plan (VLAP) as it adopted all necessary legislative and planning changes. The Government started implementation of the second phase of the VLAP (enforcement of the changes). The process of implementation, however, was slow.

Population (without Crimea): 42.7 m

Industry/GDP: 19%

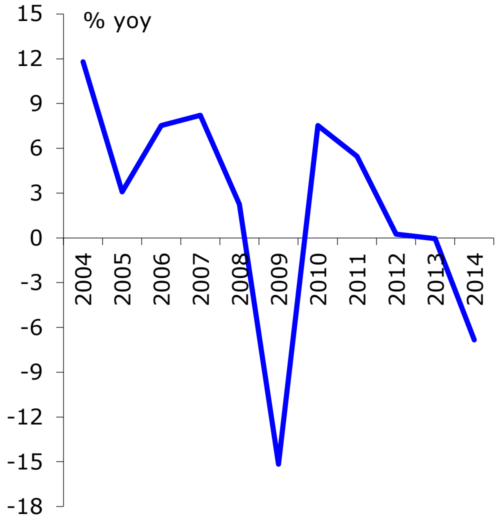
Agriculture/GDP: 10%

Investment/GDP: 14%

Exports to: Russia 18%, EU 32%

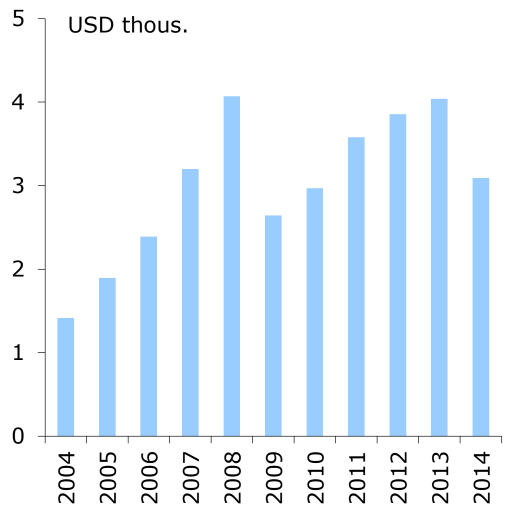
Imports from: Russia 23%, EU 39%

Real gross domestic product



Source: Ukrstat

GDP per capita

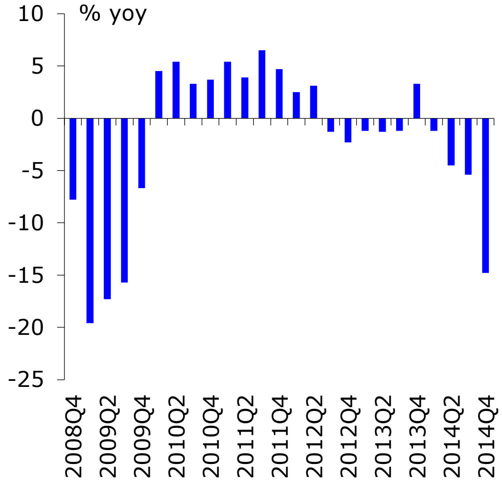


Source: Ukrstat

Russia. In February, at the most critical moment of the political crises in Ukraine, Russia started a war against Ukraine. The war was undeclared and unconventional: it included a combination of covert military interventions, incitement of uprising, a massive propaganda campaign, terrorist attacks, and economic pressure. Evidently, Russia had two objectives: (1) annex Crimea, a peninsula with population of 2.4 m in the South of Ukraine, and (2) destabilize the country to bring to power a pro-Russian government in Kyiv.

The first objective was achieved in a short time. On February 27, Russian forces seized the main local government buildings in Simferopol, the regional capital of Crimea. In the subsequent few days they took control over main transport hubs and blocked Ukrainian military bases, taking advantage of the support from a part of local officials, police officers and military servicemen. Ukrainian army did not try to stop Russian troops. Russia also organized a quick "referendum" to legitimize the occupation[i] on March 16, and on March 21 officially annexed Crimea. The annexation was not recognized by Ukraine and by the international community.

Real GDP growth

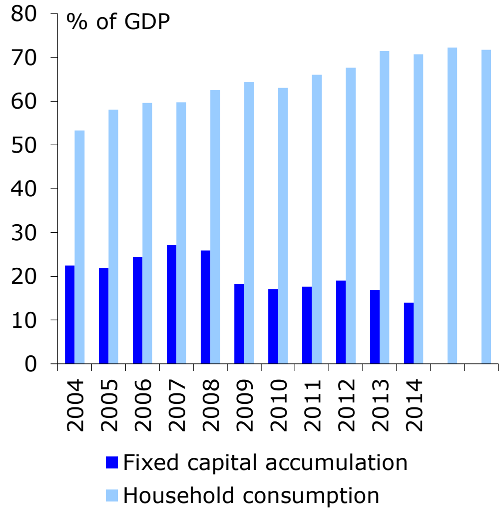


Source: Ukrstat

The second objective was not completed despite significant efforts. Russia tried to organize a separatist uprising in the East and in the South of Ukraine, in the regions with predominantly Russian-speaking population. The uprising could have helped Russia to take control over local governments, and then use them to change the central government in Kyiv by threatening to split the country. Russia's efforts included also a fierce mass propaganda campaign depicting Ukrainian government as a "fascist junta" manipulated by the West, and strong economic pressure. In particular, in June Russia cut off gas supplies to Ukraine (see *Energy sector*). During the year Russia also gradually expanded the trade war that was launched in 2013 by banning most of food imports from Ukraine (the list of banned or restricted products included all plant products, dairy products, poultry, pork products, canned fish, juices, beer, alcoholic beverages, and confectionery (see *Merchandise Trade*).

However, those efforts brought limited results. In April, an armed rebellion spread over Donetsk and Luhansk regions (together referred to as Donbas), but in other regions Russia's efforts did not succeed as intended. On the contrary, Ukrainian regions rallied to confront the aggressor. The EU and the USA, which took the side of Ukraine in the conflict, began the policy of isolating Russia. Western sanctions helped to force Russia to refrain from a large-scale military intervention into mainland Ukraine. The result that Russia got was a long war in Donbas, which contributed to deepening the economic crisis in Ukraine. The exclusion of pro-Russian voters in Crimea and Donbas changed Ukrainian electoral landscape making it impossible for pro-Russian forces to come to power through democratic procedures in the future (at least until Crimea and Donbas come back under the control of Ukrainian government).

Structure of gross domestic product



Source: Ukrstat

The war in Donbas. The war in Donbas, which became the hottest part of the undeclared Russian-Ukrainian war, began on April 12, when unknown separatist gunmen took control over the town of Slavyansk. Ukrainian government forces began a military operation against them. The scale of the war, officially called an "anti-terrorist operation" in Ukraine, increased gradually as it spread to other towns in Donetsk and Luhansk regions, and became more intensive. Russian government directed separatists and supported them by supplying weapons (including tanks, cannons, multiple launch rocket systems, and air-defence systems), sending soldiers to Ukraine and deploying troops on the border with Ukraine.

In July and June, operations of Ukrainian troops were mostly successful. They gradually forced the insurgents out of a number of towns and villages. However, in late August Russia used its regular troops to stop the advance of Ukrainian forces and caused substantial damage to them. On September 5, representatives of Ukraine, Russia, Donbas insurgents, and the OSCE signed a protocol on a permanent ceasefire. Large-scale military operations stopped, but low-intensity fighting continued until the end of the year. As a result of the war, besides Crimea, Ukraine lost control over an area of approximately 16,000 sq. kilometres in Donbas (2.7% of the total area of Ukraine including Crimea) with a pre-war population of about 3.8 m. At least 800,000 people were displaced internally or left Ukraine, and at least 4,700 people were killed. Apparently, a long-term military conflict within the territory of Ukraine, which may hinder development of Ukrainian economy for many years, was created.

The IMF. In 2014, Ukraine resumed cooperation with the IMF. In April, the IMF approved a two-year Stand-By Arrangement (SBA) in the amount of SDR 11 bn (USD 17 bn) for Ukraine. The SBA was designed to support an economic reform program aimed at ensuring macroeconomic stability and implementing structural changes. In May and September, Ukraine received two disbursements of the loan at the total amount of SDR 3 bn (USD 4.7 bn). Further disbursements were suspended in anticipation of the change of government after the October parliamentary election and because of slow reforms.

GDP: Ukraine’s economy in recession

The year of 2014 was the most difficult for Ukraine in the XXIst century. The country experienced economic crisis, military conflict in the East and annexation of Crimea. Crisis deepened throughout the year as real GDP dropped by 1.2% yoy in the first quarter and by 14.8% yoy in the fourth quarter. Real gross value added declined in all sectors, except for agriculture and nonmarket services such as public administration and defence as well as healthcare and social work, due to conflict in the Eastern Ukraine. Overall, real GDP declined by 6.8% in 2014.

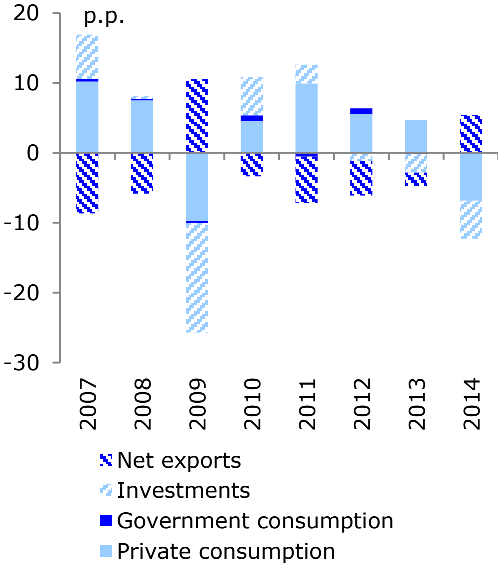
On expenditure side, domestic demand dropped significantly. In particular, real private final consumption declined by 9.6% due to drop in real disposable income (see *Wages and income*). High economic and political uncertainty resulted in decline in saving rate. Loan repayments outpaced new loans issued suppressing consumption (see *Financial markets*). At the same time, spending on purchases of cash foreign currency by households increased due to high exchange rate (although dollar equivalent dropped).

Real gross fixed capital accumulation dropped by 23.0% against the background of high economic and political uncertainty (see *Investments* and *Business climate*). Most acute drop was in spending on (mostly imported) machinery and equipment. In particular, lack of own cash (see *Financial results of companies*) as well as restricted and expensive banking lending did not allow companies to invest into modernisation projects. At the same time, investment in residential housing funded by private citizens increased by 1.6% Fiscal outlays for investment in fixed assets dropped but investment in R&D and defence articles increased due to fiscal constraints and changed priorities (see *Fiscal policy*).

Decline in domestic demand resulted in drop of imports of goods and services. Purchases of imported goods were also reduced due to imports substitution against the background of sharp hryvnia depreciation (see *Exchange rate policy*). Besides, Ukraine reduced imports of natural gas due to lower consumption and gas imports dispute with Russia (see *Energy sector*). Overall, real imports of goods and services declined by 22.1%. At the same time, real exports of goods and services declined slightly less (by 14.5%) due to weak external demand and trade tensions with Russia (see *Balance of payment* and *Merchandise trade*) as well as disruption of production in the Eastern Ukraine (see *Industrial output*). As a result, net real exports made positive contribution to real GDP growth at 5.3 p.p.

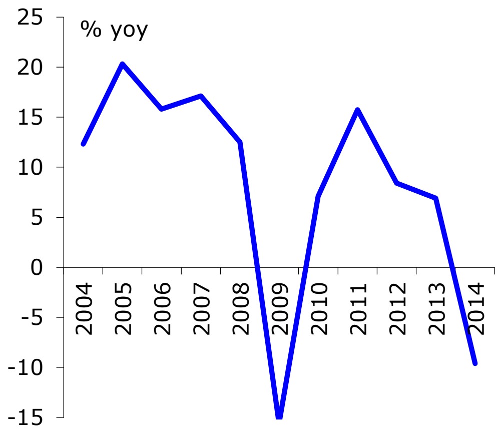
On production side, real gross value added (GVA) declined in all sectors, except for agriculture, healthcare as well as public administration and defence. Good crop harvest resulted increase in

Contributions to real GDP growth



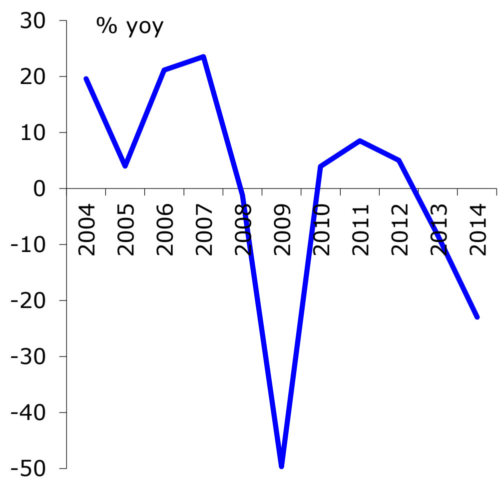
Source: Ukrstat

Real households' final consumption



Source: Ukrstat, IER calculations

Real gross fixed capital accumulation



Source: Ukrstat

real GVA in agriculture by 2.9% despite limited access to borrowing and disruption from military conflict (see *Agricultural output and trade*). Real GVA in healthcare and social assistance increased by 3.9%, while GVA in public administration and defence increased by 2.6%. This likely reflected increase in number of security personnel, army and military medics.

At the same time, real GVA in industry dropped by 12% primarily due to the military conflict in the Eastern Ukraine, which resulted in stoppages of many companies (see *Industrial output*). Conflict in the East also created transport and supply problems for companies in other regions although industrial enterprises were quite resilient to disruption of economic links. Real GVA in industry was by 19.4% lower than in 2011.

Real GVA in construction reduced by 19.9% due to restricted financing and sharp pullback in investment plans by state and state-owned companies. Lower domestic consumption and external trade explain downturn of real GVA in trade by 12.8%. Real GVA in transport declined by 6.6% due to lower freight turnover as well as smaller gas transit (see *Transport*).

Investments: Sharp drop

Gross fixed capital accumulation. Investments sharply dropped in 2014 due to economic crisis and high risk perception by majority of investors. Revenues downfall, increase in prices of imported goods (in hryvnia equivalent due to sharp depreciation), debt servicing, and high political uncertainty made companies to suspend investments in modernization projects. As a result, the gross fixed capital accumulation (GFCA) dropped by near 23% in 2014, which undermines perspectives for economic growth in the medium term. Real GFCA was by 27.5% lower than in 2007. Investments in commercial construction and machinery (that together account for 74.3% of investments), dropped by 25.5% and 34.7%, respectively. At the same time, investments in residential buildings increased by 1.4% due to continued demand.

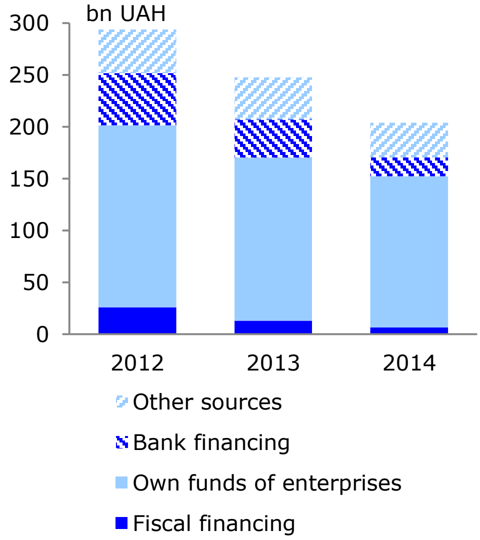
Capital investments. Investments in fixed capital (which is a narrower category than gross fixed capital accumulation) declined by 24.1%. Own cash became even more important source of financing for companies accounting for 71.5% of all capital investments (as compared to 63.4% in 2013). At the same time, share of bank lending for investments purposes reduced by 6 p.p. to 8.8% due to very high interest rates against the background of uncertain future on investment returns (see *Financial sector*). High fiscal pressure and necessity to increase spending on security and defence items resulted in sharp reduction in investments at the account of central and local budgets by 80% in real terms. Capital investments reduced in almost all sectors. Investments in the industry dropped by quarter after increasing by 2% in 2013. Agriculture reduced investments by 15.6%. Investments in construction reduced by 19.3%. Despite the uneven reduction of investments, the effect on the overall structure of investments by type of economic activity was small.

Industrial output: Downturn in all sectors

In 2014 industrial output declined by 10.1% primarily due to military conflict in the East. However, industrial output increased in 9 oblasts west of Dnipro river. It is estimated to decline by 4.1% in 23 regional units excluding Donetsk and Luhansk oblasts. Domestic and external demand for Ukrainian goods remained weak during the year.

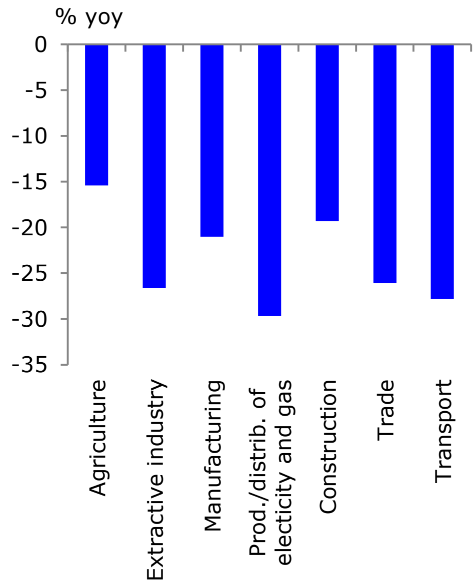
Output in extractive industry contracted by 13.7%. In particular, extraction of coal dropped by 30.5% as many coal mines either terminated or stopped operation due to military conflict in the Eastern Ukraine. Overall, more than half of Ukrainian mines are situated in the occupied territory. Some of them were able to partially restore their work by the end of the year, but stopped reporting to the Ukrstat. Overall reported drop in coal extraction reached 57% yoy in December. Iron ore extraction reduced by 6.6%

Sources of capital investment financing



Source: Ukrstat

Capital investments in 2014



Source: Ukrstat

due to drop in steel demand. Extraction of crude oil and natural gas reduced by 1.7% (see *Energy sector*).

Manufacturing production contracted by 9.3% due to lower output in most sectors. Production in metallurgy dropped by 14.5% as companies in the occupied territories either stopped their operation or did not report to the Ukrstat. Besides, companies of the sector in the rest of Ukraine reduced or terminated production in the second half of the year due to disrupted supply chains and logistic problems. In particular, some of them faced coke and coking coal shortages. External demand for steel also was weak, even though Ukrainian steel producers gained some price competitiveness at the international market due to sharp hryvnia depreciation (see *Exchange rate*). Military conflict in the East as well as restricted access to natural gas and weak external demand resulted in decline of chemical industry production at 14.2%.

Production of oil refineries dropped by 18.8% (after decline by 22.7% in 2013) as companies of the sector were not able to recover their operation. In particular, it was difficult to compete with imported oil products.

Machine building production dropped by 20.6% due to low demand. In particular, domestic demand for its produce dropped substantially due to financial constraints. Decline in purchasing power of households resulted in drop of production of vehicles by 45.8%. Low demand from Russia due to trade tensions and lack of demand for locomotives and railway carriages[ii] by Russian Railway Company as well as forbidden exports of machine building produce of dual usage by Ukraine resulted in drop in exports.

At the same time, imports substitution supported performance of industrial sectors that are mostly oriented on domestic market. In particular, food sector (excluding beverages and tobacco) increased production by 4.6%. Sugar production grew by 66.8% and sunflower oil production increased by 26.7% due to good harvest (see *Agricultural output and trade*). Production of milk products increased by 0.1% despite bans on dairy products imports imposed by Russia. Output of meat and meat processing products grew by 0.5%. At the same time, production of sweets and chocolates reduced due to lower domestic (due to lower purchasing power of households) and external (due to trade tensions with Russia) demand.

Domestically oriented pharmaceutical companies were able to increase production by 1.9% as their sales were supported by imports substitution under limited purchasing power of households.

Overall, production of investment goods dropped by 20.3% due to lower investments (see *Investments*). At the same time, production of durables contracted less (by 11.3%) and production of consumption goods increased by 1.7% likely due to imports substitution.

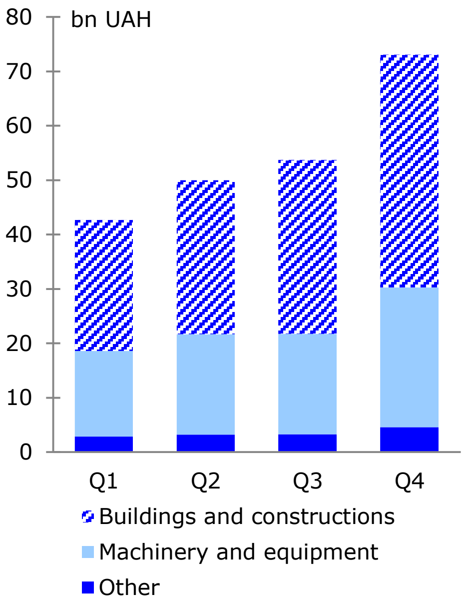
Production and distribution of gas and electricity declined by 6.6%. This was explained by disruptions in production of energy (see *Energy sector*) as well as warmer weather.

Agriculture: Record grain harvest

In 2014, agricultural production increased by 2.8%. As in the previous year, production of enterprises grew faster than production of households (by 4.1% and 1.2%, respectively) as companies are dominant in growing of oilseeds and grains, which had good yields. Agriculture in 2014 was the only sector with increased real gross value added due to high crop harvest. As a result, the share of agriculture in GDP increased by 1.5 p.p. to 10.3%. Agri-food exports decreased by 2.1% in US dollar equivalent, but increased to 30.9% of total exports of goods (as compared to 25.6% in 2013).

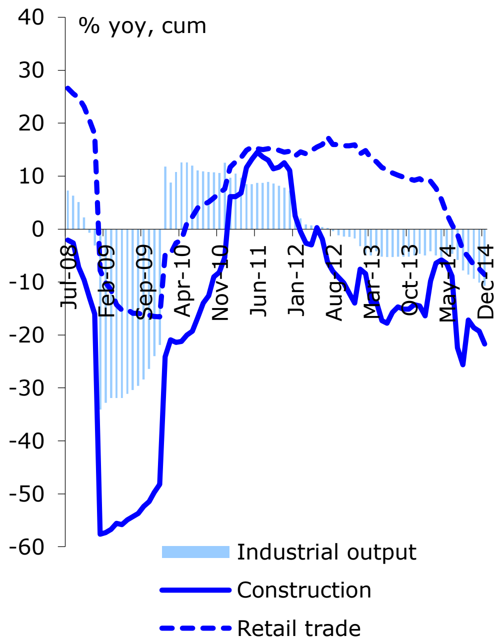
Crop production. Total crop production grew by 5.3%, while total harvested area decreased by 0.6% (711 000 ha). Grains and pulses, and potatoes accounted for 48.8% and 18.1% of crop production, respectively.

Gross fixed capital accumulation in 2014



Source: Ukrstat

Real sector trends



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

Record harvest of grains and pulses at 63.8 m t (with the share of food grains at 39%) was gathered in 2014, which is the largest crop in the history of independent Ukraine (especially taking into account currently lost territories due to annexation of Crimea and military conflict). Such high results were attributed to significant increase in average yields of all cereals, except for corn and rice (particularly, 15.6% increase for wheat and 25.4% for barley). Yields increased likely due to favourable weather conditions and 5.7% increase in mineral fertilizers usage. The share of grain harvested by agricultural enterprises and households' farms (78.7% and 21.3%, respectively) did not change compared to the previous year.

Agricultural producers paid more attention to producing sugar beets after reducing harvesting area for this crop in 2013. In particular, cropping area under sugar beets increased by 21.8%. Overall, sugar beets production grew by 44.2% also due to higher yields.

Households continued to specialize in growing labour intensive cultures: potatoes (96.8% of gross production), vegetables (86.1%), fruits and berries (83.4%). While production of potatoes and vegetables in 2014 increased by 8.4% and 2.6%, respectively, production of fruits and berries decreased by 7.8%.

In 2014 sunflower harvest was by 7.7% lower than in the previous year due to drop in yields by 11.4%. Still, apart from 2013 harvest, it was the largest crop in the history of Ukrainian statistics. Decrease in the average yield might be the sign of lack of financial resources and soil exhaustion.

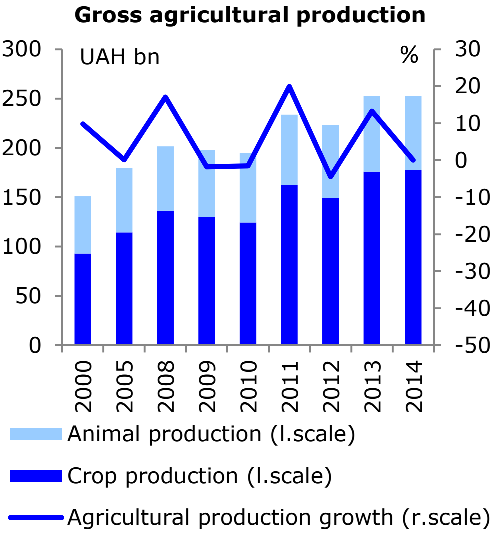
Rapeseed production fell by 5.8%, while soya production increased by 41.3% due to changes in harvested areas. Changes in the harvested area for these crops likely represent farmers' price expectations.

Livestock production. In 2014, meat production grew by 4.3% with an increase at 6.4% and at 1.5% for agricultural enterprises and households' farms, respectively. Agricultural enterprises expanded pork and poultry production by 4.2% and 7.3%, respectively, but cattle breeding decreased by 5.3%. In comparison to previous year, growth rates for all types of meat production decelerated likely due to decline in investments against the background of high political uncertainty.

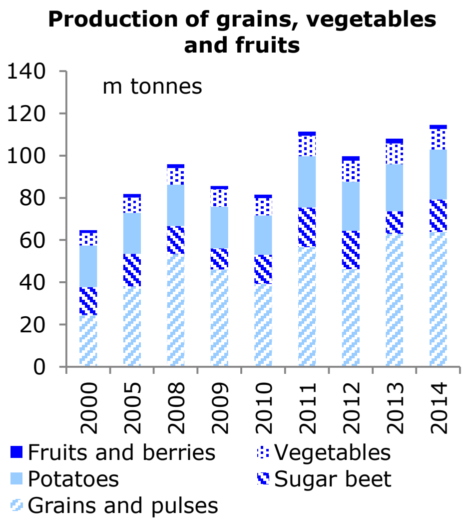
The share of households' output in meat production declined from 42.1% to 40.9%. A general trend of increasing share of agricultural enterprises is observed since 2005. This contributes to higher gross output of agricultural sector as agricultural enterprises have a higher potential to increase productivity and ensure food quality and safety. At the same time, animal husbandry is important for rural population as it provides jobs and supports livelihoods of rural communities.

In 2014, milk production increased by mere 0.4% to 11.2 m t. The number of cows owned by enterprises and households declined further by 3.2% with 5.0% decrease for enterprises and 2.8% for households. This is likely to be a consequence of a ban on imports of Ukrainian dairy products by Russia, oversupply of domestic market and resulting fall in the producer price[iii].

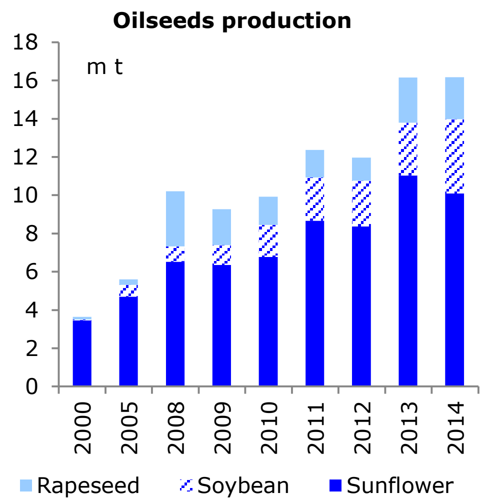
Agri-food exports. Trade surplus in agri-food sector increased by 20.5% to USD 10.6 bn due to sharper drop in imports (by 24.7%) than in exports (by 2.1%). The introduction of tax-free import quota by the EU for Ukraine has not yet led to significant impact on agri-food exports (see *Trade policy*). Food exports dropped by 11.5% as Russia imposed bans on imports of these goods from Ukraine. At the same time, exports of animal fats and vegetable oils increased by 9.3% (with India as the largest exporting market). Value of grains export (main Ukrainian agricultural export product) increased by 21.1% (to USD 1.9 bn) in 2014 due to larger sales to Egypt, Spain, Pakistan, and North Korea. The most significant decline in imports was for the products of animal origin (by 39.3%), especially for meat (by 61.4%).



Source: Ukrtsat
*2014 data not including territory of Crimea



Source: Ukrstat
*2014 data not including territory of occupied AR Crimea



Source: Ukrstat
*2014 data not including territory of occupied AR Crimea

Agricultural policy: Turning towards Europe

Agricultural policy efforts were primarily driven by the implementation of the Association Agreement (AA) with the EU, which envisages the fully fledged implementation of the DCFTA.

Harmonization of legislative acts. According to the AA Ukraine should harmonize Ukrainian legislation with European standards including norms on elimination of non-tariff trade barriers. There are five Laws that need to be adopted in order to harmonize our food safety regulations[iv]. Two of them (concerning food safety system[v] and animal identification[vi]) were adopted in 2014 and2015. These laws are expected to improve domestic food safety system, decrease conformity costs for Ukrainian producers and allow producers to export their produce to the EU market.

In April 2014, the Parliament adopted a Law[vii], according to which, European system of phito-sanitary control of animal products is considered to be equivalent to Ukrainian one. The Law aims to reduce transaction costs for importers and thus will benefit Ukrainian consumers.

Deregulation. The Parliament cancelled the mandatory certification of grain elevators and released the importers of plant protection products from the requirement to obtain approval for the imports of each individual party of products[viii]. Producers' benefits from such changes are estimated at UAH 1 bn[ix].

In September 2014, the Government united the State Veterinary and Phytosanitary Service, the State Inspectorate for Consumer Protection and the State Sanitary and Epidemiological Service into one Service[x]. This decision is expected to reduce significantly administrative pressure on producers.

State aid. In 2014 Parliament changed the regulation on state aid to agricultural companies.[xi] Since January 2015, small and medium farms became also eligible for the compensation of construction costs. This can potentially help to boost livestock production.

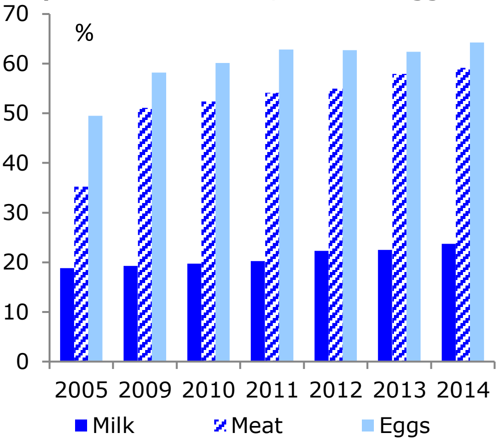
Autonomous trade preferences. As the establishment of the DCFTA was postponed until 2016 and due to difficult economic situation in Ukraine the EU took a decision to provide Ukraine companies with autonomous trade preferences since April 2014.[xii] The EU cancelled import duties on 83.4% of headings of Ukrainian agricultural goods and foodstuff and introduced duty-free tariff quotas (TRQ) for a number of agricultural products. As of December 2014, TRQ on natural honey, cereal grains, fruit juice, processed tomatoes, corn, poultry and wheat were fully exhausted.[xiii] However, the use of TRQ for starches, onions and barley was below 10% due to specific for products reasons. Onion producers are usually small farmers, which makes complicated for them to enter foreign market. Quota for starches, according to experts, is set below the minimal profitable level. Lastly, barley producers have no problems in finding a buyer for their product, and, thus, they can be uninterested in the EU market. Export of dairy products and meat (other than poultry) has not yet started because of noncompliance of Ukrainian products with EU standards.

Taxation. Fixed agricultural tax was reclassified as a subcategory of single tax.[xiv] The criteria for fixed agricultural tax eligibility remained unchanged. However, all the acts that regulate administration of the tax remained yet unchanged. Thus, in the perspective, the changes will probably have no effect on producers.

Energy sector: Total deficit

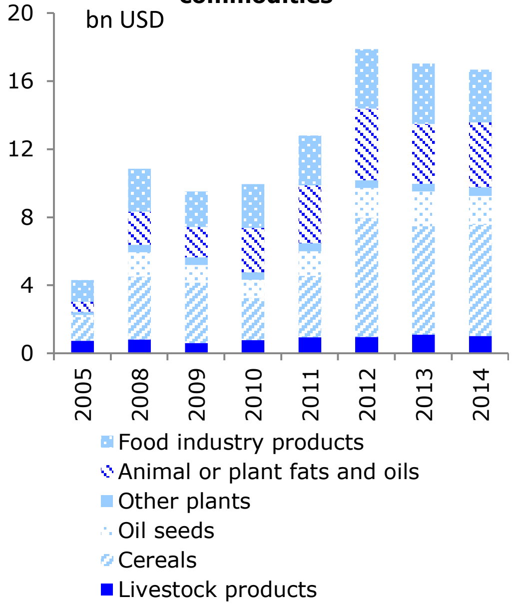
Natural gas supply. In April, Russia raised gas price for Ukraine from USD 268.5 per tcm to USD 385.5. In June, the Gasprom introduced advance payments for gas purchases by Ukraine and pressed charges in the Stockholm Arbitrage Court with the claim that the Naftogaz has not paid in time USD 4.5 bn. At the same time, the Naftogaz filed in the same court against the Gasprom to set a fair market price for gas and to compensate USD 6 bn for the gas

Share of agricultural enterprises in production of meat, milk and eggs



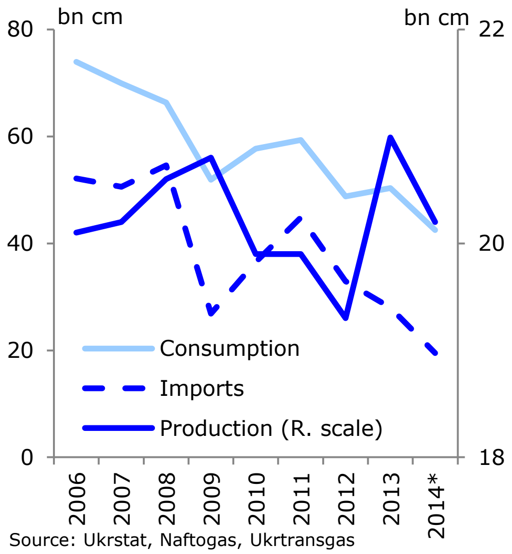
Source: Ukrstat
*2014 data not including territory of occupied AR Crimea

Export of agricultural and food commodities



Source: Ukrstat
*2014 data not including territory of occupied AR Crimea

Natural gas flows



Source: Ukrstat, Naftogas, Ukrtransgas
* without Chornomornaftogaz

overpaid since 2010. In July, the Gasprom stopped gas supplies to Ukraine due to a price conflict.

Due to conflicts with gas supplies from Russia, Ukraine had to look for gas elsewhere. The year of 2014 became a year of breakthrough for reverse gas flows in Ukraine with three gas routes acting by the end of the year: via Poland, Hungary and Slovakia. The biggest and the most promising is the Slovakian route with 40 m cubic meters of gas daily capacity which was opened in September. In 2014, Ukraine received 26% of its gas imports from Europe. Main European suppliers were German and Hungarian companies.

As a result, the structure of origin of imported gas changed in 2014. Ukraine boosted the reverse gas supplies from Europe by 59% to 5.1 bn cubic meters (bcm). The increase in gas supplies from Europe was ensured by the opening of the Slovakian route (3.6 bcm). The rest of the gas came via Poland (0.9 bcm) and Hungary (0.6 bcm). As a result, the share of Russian gas in Ukrainian gas imports declined by 18 p.p. to 74%. At the same time, the volumes of Gasprom's supplies dropped by 48% to 14.5 bcm as Ukraine stayed for half a year without the Gasprom gas. Gas supplies from Russia resumed only in December after lengthy negotiations with the intermediation of the European Commission, which was anxious to guarantee gas supplies to Ukraine and undisrupted gas transit to Europe for the winter season.

The average price of Russian gas for Ukraine constituted USD 268.5 per 1000 cubic meters (tcm) in January-April 2014 and USD 385 per tcm in December. The price of gas supplied by European countries was around USD 350-360 per tcm.

Overall, in 2014, imports of natural gas declined by 30% to 19.5 bn cubic meters (bcm). Gas extraction in Ukraine decreased by 1 bcm to 20 bcm mainly due to the loss of Chornomornaftogaz capacities after the annexation of Crimea.

Gas consumption. In 2014, Ukraine decreased consumption of gas by 16% to 42.6 bcm. In particular, industrial consumers reduced consumption by 22% due to drop in production (see *Industrial output*). At the same time, lower consumption of utility companies and households (by 16% and 10%, respectively) might be explained by a relatively warm winter and energy saving measures. The share of Ukrainian gas in consumption was 51% (20.5 bcm). In 2013, the share of Ukrainian gas in consumption was 42.

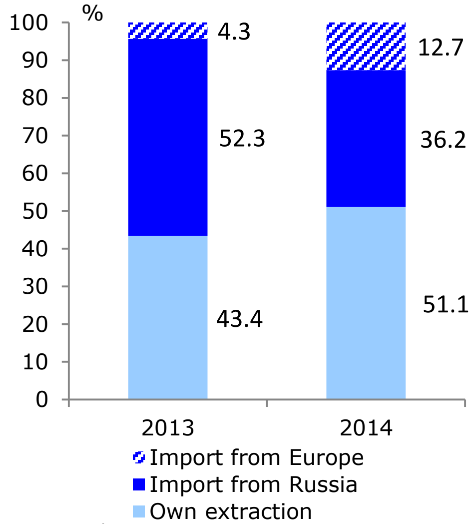
To reduce gas consumption the Government in August set gas consumption limits for industrial and heat generation companies urging them to decrease consumption by 10-30%. In October, chemical producers were forbidden to use the gas of Ukrainian origin or gas from underground storages for the production purposes due to the shortage of gas and had to purchase it directly from European suppliers.

Non-traditional gas. In January 2014, Royal Dutch Shell stopped negotiations on exploration of Skifska gas field in the Black Sea and exited the project due to constant postponing of signing the agreement since late 2012.

In August, the rent for gas extraction was increased from 28% to 55% (for depths up to 5km) and from 15% to 28% (for other depths). This caused Chevron's exiting in December the product sharing agreement on shale gas exploration of Oleska field.

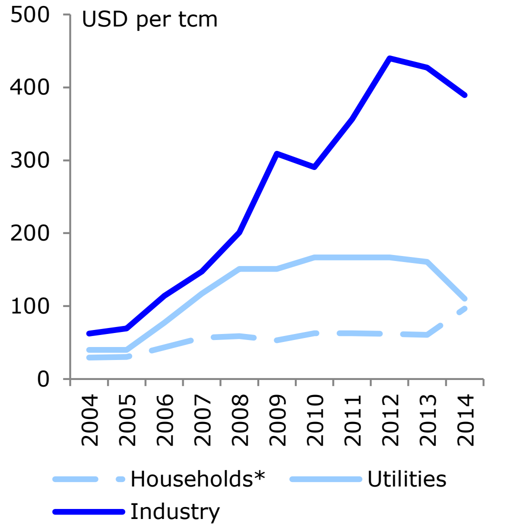
Transparency. In May, the Naftogaz joined the Aggregate Gas Storage Inventory (AGSI+) transparency platform of Gas Storage Europe (GIE) and started reporting the gas volumes stored in Ukrainian underground storage facilities. This move highly increased transparency on the gas market. Also in May, Ukrtransgaz started publishing data on the volumes of gas transported via Ukrainian gas transit system. However, the Naftogaz hasn't published yet its financial report for 2014 which hampers the transparency of the gas sector.

Share of gas sources in consumption of gas



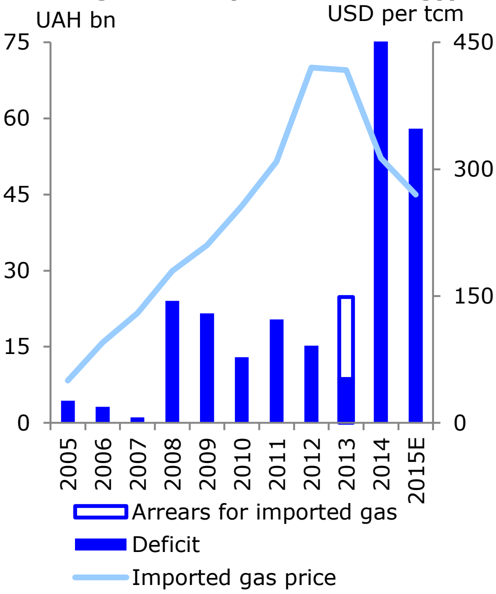
Source: Ukrtransgaz

Domestic gas prices



* For households consuming less then 2500 cm per year
Source: Ukrstat, Naftogas, Ukrtransgas

Naftogaz deficit (IMF methodology)



Source: MinFin

Gas transit. In 2014, Ukraine decreased gas transit of Russian gas by 28% to 62.2 bcm. The share of Ukraine in total Russian gas exports to Europe decreased by 11 p.p. to 42%. It happened due to the opening of the Nord Stream pipeline that bypasses Ukraine with the full capacity of 55 bcm per year and to the decrease of gas consumption in Europe by 11%.

In October, the Naftogaz filed a suit to the Stockholm Arbitrage Court for renegotiation of the gas transit contract with the Gasprom to change it according to European regulations.

Oil market. The crude oil extraction in Ukraine dropped by 6% to 2 m t. The share of imported oil products at the Ukrainian market reached 90-95% in 2014.

Coal market. Coal extraction in Ukraine decreased by 22% to 65 m t due to the disruption of coal extraction at the occupied territories in Donbas.[xv] The state-owned coal mines were extremely inefficient as the average costs of extracted coal was UAH 1220 per t compared to the average wholesale price of UAH 607 per ton.[xvi] In 2014, Ukraine imported USD 1.7 bn worth of coal.

In May, the Government prohibited direct sales of coal by coal mines. All the coal had to be sold only via the state-owned trade company the *Coal of Ukraine*. This disrupted competition on the coal market and created a state monopoly in coal trading.

In September, Ukraine experienced the deficit of energy coal of about 1 m tons per month due to military operations in Donbas and the fact that all mines extracting energy coal are situated in this region. By the end of the year, only 24 out of 95 state mines in the East were in operation. As a result, Ukraine started coal imports from the South Africa[xvii] and later from Russia. In December, the Government introduced licensing for energy coal exports in an attempt to encourage the coal traders to sell the coal domestically and to induce the energy companies to use more of the coal of the gas group for electricity production. However, these measures had little effect on energy coal deficit.

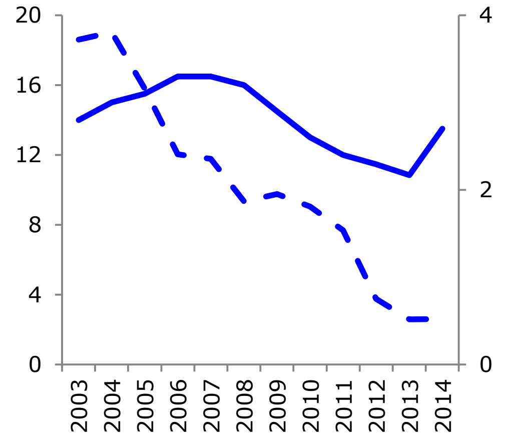
Electricity. On January 1, 2014, the law "On the Principles of the Electricity Market of Ukraine", which started the electricity market reform, came into force.[xviii] The traditional for Ukraine "pool" market model[xix] with one buyer has to be gradually transformed to the competitive market model by July 1, 2017. The generation and transmission of power (currently managed by NEC Ukrenergo) are to be unbundled, while new principles of electricity trade based upon bilateral contracts mechanism and spot "day-ahead" market (including balancing market component) are to be introduced. However, this is a framework law that requires adoption of a number of secondary regulations, which were not adopted in 2014. Therefore, the law does not work yet and the reform has not started.

In June, the Ukrinterenergo started electricity supplies to Crimea at market prices based on bilateral agreements. In September, the company warned about possible limitations on electricity supplies to Crimea due to the lack of coal at thermal power plants (TPPs) and later limited electricity exports by 50%. Electricity shortages were experienced in Kharkiv and Kyiv regions. In October, Ukraine stopped electricity exports to Belarus.

Due to shortage of capacities to generate enough electricity, in November, Ukraine started negotiations with Russia on electricity imports and in the beginning of December the Government allowed temporary imports of electricity from neighbouring countries. However, the agreement on electricity imports from Russia was reached only on December 28. Overall, in December, average daily electricity deficit in Ukraine was 2500-3000 MWt (it reached 6000 MWt by mid-December).

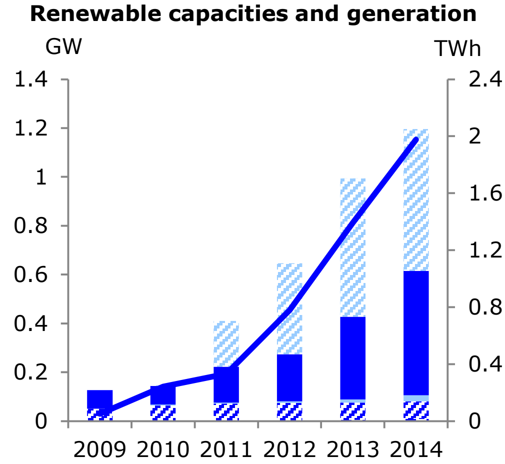
Renewables. In 2014, all renewables generated 1123 GWt of electricity or 0.62% of the total electricity generation. The total installed capacities in 2014 reached 409.5 MWt. Therefore, Ukraine is not approaching to targets defined in the Energy Strategy for Ukraine

Oil extraction and domestic refining



* Gasoline, diesels and heavy fuel
Source: Ukrstat

Renewable capacities and generation



Source: NCER

till 2030.[xx] The Strategy envisages that by 2030 the share of renewables in the total installed capacities for electricity generation is to reach 12.6% (or around 8 GWt under basic scenario).

In April, the electricity tariffs for renewables were increased by 20.1% to UAH 1.6645-6.8481 per kWt*h due to the change in exchange rate. In July, the Verkhovna Rada abolished EPT exemptions for electricity producers for electricity generated from renewable sources. In August, the Government adopted the resolution on the procedure of establishing the state of emergency on the energy market and the National Commission for State Energy and Public Utilities Regulation (NERC) temporarily stopped adjusting electricity tariffs for renewables. This move might be explained by the financial crisis in Ukraine and the lack of funds to pay high tariffs for renewable energy. However, it adversely affected the investment climate in the sector as it lengthened the payback period for the projects in renewables.

Tariffs. From January 1, 2014, marginal price of gas was decreased by 10% to UAH 3113 per tcm for industrial consumers, by 29.2% to UAH 2448 per tcm for public enterprises due to a new gas deal with Russia. The tariffs for production of thermal energy were also decreased for 48 electricity and heat generation companies as well as electricity tariffs for 33 combined heat and power stations (CHPs).[xxi]

The Government announced its plans to drastically decrease energy subsidies paid through low tariffs to the population and move to direct monetary assistance to the poor. To decrease the subsidies and budgetary support for the Naftogaz the NERC increased energy tariffs throughout the year due to the announced schedule. In June, the NERC increased electricity tariffs for households by 10-40% depending on consumption volumes. To fight electricity shortages, in December the coefficients for using electricity at peak hours for industrial consumers increased by 23.3% to 1.85 for two-zone tariffs and by 19% to 2.0 for three-zone tariffs. Electricity tariffs for industrial consumers increased by 21-27% in 2014.

The NERC increased gas tariffs for households from May 2014 by 56% on average to UAH 1.089-4.011 per m^3 depending on consumption volume. The last increase of household gas tariffs was in 2010 by 50% to UAH 0.7254-2.4732 per m^3.

In 2014, the tariff for storing gas in the underground storage facilities was increased by 2.6 times to UAH 46.2 per tcm. The tariffs for pumping gas to and from the storages also increased by 4.4 times to UAH 32.9 per tcm. This was the first increase in tariffs for the last seven years.

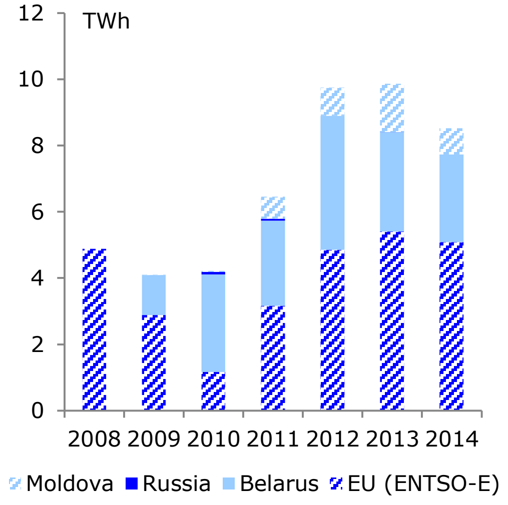
Transport: Continued decline

Market trends. In 2014, the situation in transport sector of Ukraine continued to worsen due to military conflict in the East, annexation of Crimea and economic recession. Freight turnover contracted by 10.8%[xxii] and passenger traffic (measured in passenger-kilometres) decreased by 11.7%.

The biggest contraction of freight turnover was recorded in pipeline (by 26.4%) due to reduction of gas transit volumes and disruption of gas supplies from Russia (see *Energy sector*). Air freight turnover fell by 11.7% and automobile by 5.1%. At the same time, Ukrainian sea ports increased freight volumes by 4% in 2014 and freight turnover by 18.5% likely due to freight re-orientation from Crimean ports. The biggest share belonged to Yuzhniy (30%), Odesa (17%) and Mykolayiv (15%) sea ports.

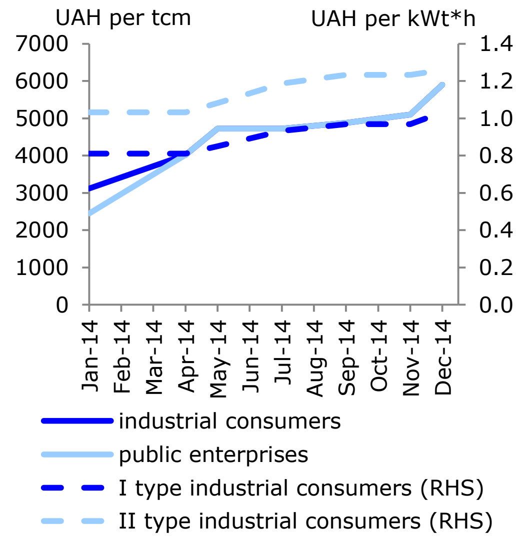
Water and railway passenger traffic dropped the most among all means of transport, by 27.6% and 21.7%, respectively. Air transport passenger traffic decreased by 4.9%. In 2014, 35 Ukrainian air carriers operated on the market and transported 6.5 m passengers and 78700 t of cargo. The biggest passenger air carriers in 2014 were Ukraine International Airlines, WizzAir Ukraine and Utair-Ukraine. At the same time, transportation by automobile fell by 7.5%.

Electricity export



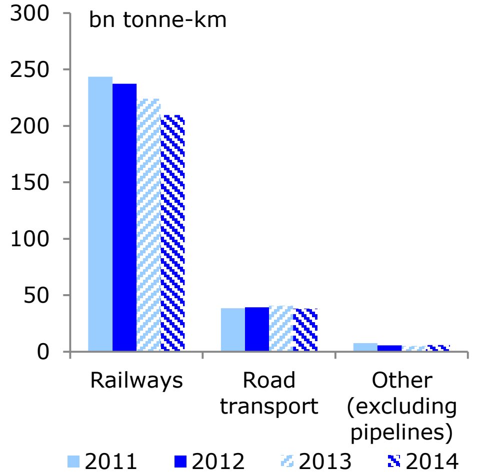
Source: NCER

Gas and electricity tariffs



Source: NCER

Freight transportation



Source: Ukrstat

Tariffs. In July 2014, the Ministry of Infrastructure raised rail freight rates on average by 12.5%. At the same time, rates for transporting grain were increased by 21%.[xxiii] According to UZ, that helped to decrease disproportions in rail tariffs. The average freight rates of all means of transportation increased by 11.7% in 2014.[xxiv]

In August, the price of passenger transportation in express trains Intercity+ was increased by 20% due to the renewal of VAT for these services. The Ministry of Infrastructure increased base rail fares for passenger traveling in standard compartment carriages by 10% in August and by 10% in October. Resulting tariffs were still lower than cost-covering level. As a result, in 2014, the losses of the railway monopolist Ukrzaliznytsia (UZ) from passenger traffic were estimated at UAH 7.9 bn (UAH 6.7 bn in 2013). The losses were fully covered by profit from freight services. Therefore, the cross-subsidisation in the sector remained high.

Transportation policy. In June, the Government adopted a regulation on reorganizing the UZ into a public joint stock company. As a first step, in December, the UZ held a tender for a company to conduct an independent assets evaluation, which was won by Deloitte&Touche. After the evaluation is completed, the Ministry of Infrastructure is supposed to split public administration and commercial functions of the UZ. However, the Government still has to do some legislative work to reform the sector, e.g. shift to transparent procurement and adopt the new law on railway transportation.

The Ministry of Infrastructure cancelled the state regulation of tariffs for sea port services starting July 15.[xxv] This move was required by the law On Sea Ports which states that the tariffs for services should be set by the market players (article 21) except for tariffs on special services performed by natural monopolies and services paid as a part of port charges. As a result, Ukrainian sea ports link tariffs for their services to foreign currency, i.e. US dollar.

Telecommunications: Introduction of 3G

Legislation. In 2014, the National Commission for the State Regulation of Communications and Informatisation (NCCIR) announced an open tender for UMTS network (3G). Three mobile operators (Kyivstar, Astelit and MTC Ukraine) applied for the licence. The license was given in three lots (with frequencies 1920-1935/2110-2125, 1950-1965/2140-2155 and 1965-1980/2155-2170 MHz) with the starting price for each lot of UAH 2.443 bn. The tender was finally held in March 2015. The lots were sold for UAH 8.77 bn.

Market trends. According to the Ukrstat, the number of mobile phone subscribers in 2014 increased by 4.2% to 61.2 m subscribers.[xxvi] The mobile phone penetration rate is 142.4 per 100 people and is the lowest in Khmelnytska (97.8) and Ternopilska (98.1) regions. At the same time, the number of fixed phone subscribers further declined by 7.4% to 23.7 subscribers per 100 inhabitants due to the loss of competition.[xxvii] To counteract this decline the fixed phone operators offered broadband Internet access via their infrastructure. The Ukrtelecom remained the monopolistic provider of fixed phone services. Three main operators at the mobile telephone market are Kyivstar, MTS Ukraine, and Astelit.

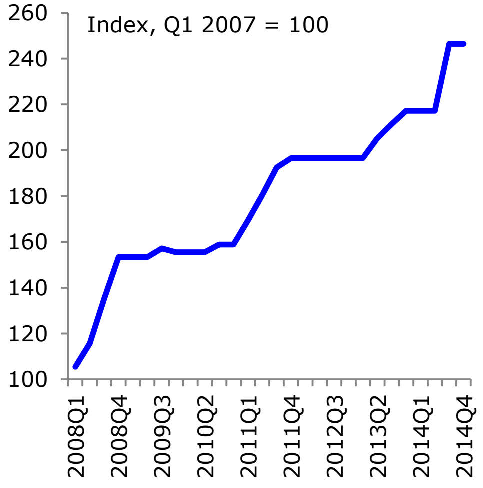
In 2014, there were 5.9 m Internet subscribers.[xxviii] The penetration rate at the household broadband Internet market was 39.3%.[xxix]

Marginal tariffs. In September 2014, the NCCIR raised marginal phone tariffs by 14% to UAH 29.91-33.26 in urban areas and by 27% to UAH 23.01-26.32 in rural areas to bring the tariff to cost covering level.[xxx] According to Ukrtelecom data, in 2014, cost of phone service was UAH 33.06 in urban areas and UAH 50.85 in rural areas.

Utilities: Increase in tariffs

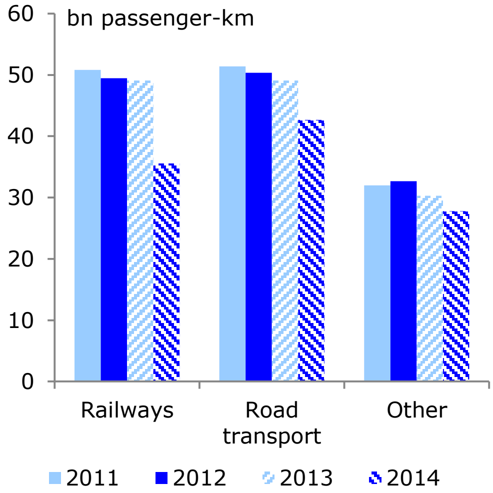
Legislation. In April, the National Regulatory Commission for Public Utility Markets of Ukraine (NCPU) was given the authority to set the

Freight rates index



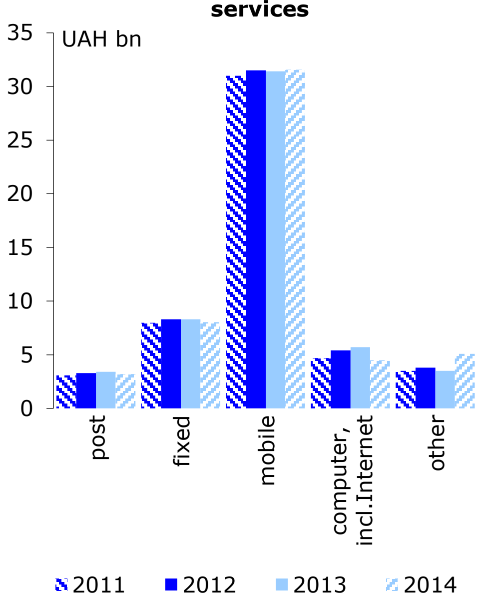
Source: Ukrstat

Passenger transportation



Source:Ukrstat

Revenues from communication services



Source: Ukrstat

tariffs for central heating and hot water supply based on the suppliers' data, which were previously set by local authorities.[xxxi] That way the Government will have more control over the heating tariffs.

In August 2014, the NCPU was substituted by new National Commission for State Energy and Public Utilities Regulation (NERC). This was done as a part of the announced administrative reform to decrease the number of control functions and state control authorities.

Central heating and hot water. The weighted average tariff for heating for budget enterprises in December 2014 was UAH 1134.9 per GCal, for other consumers (except households) it was UAH 1023.5 per GCal, while the weighted average cost of production of this energy was UAH 1104 per GCal and UAH 990.9 per GCal, respectively.[xxxii] The NERC estimates that 60% of houses in Ukraine that use district heating have no heating meters. The situation is the best in Vinnytsya region (27% of houses are without meters) and the worst in Ternopil region (with 91%).

Since August, the heating tariffs for households without heating meters were increased on average by 43% depending on region. The biggest increase was in Dnipropetrovsk region (by 59%, from 6.09 to 9.69 UAH/m^2) and the smallest was in Ternopil region (by 10%, from 6.13 to 6.77 UAH/m^2). Also in August, tariffs for hot water for households were increased on average by 50% depending on the region. The biggest increase was in Rivne region (by 87% to 20.39 UAH/m^3) and the smallest was in Odesa region (by 6 to 21.43 UAH/m^3). The difference in tariffs is explained by differing technological conditions of providing heating services in different regions of Ukraine.

Cold water supply and sewage. Houses in Ukraine are under-equipped with water meters. Only 24% of multi-apartment buildings have the meters (for the whole building), 70% of individual apartments and 63% of individual houses. Therefore, a lot of people pay for water consumption according to the set norms and have little incentive to save water. The weighted average tariff for water supply and sewage in 2014 was 6.99 UAH/m^3 (4.08 UAH/m^3 in 2013) while the weighted average cost was 6.9 UAH/m^3 compared to 5.94 UAH/m^3 in 2013.

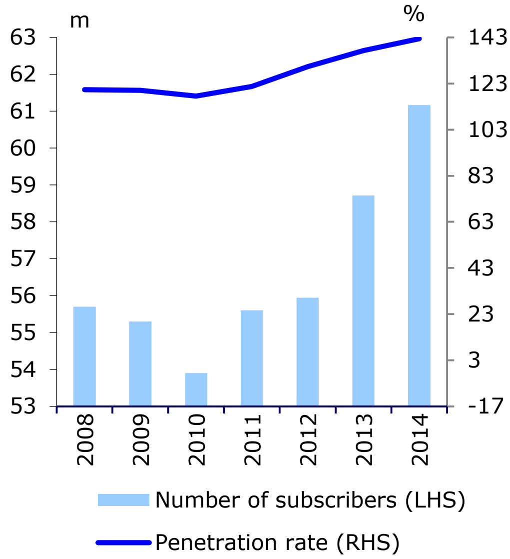
Balance of Payments: Huge deficit of consolidated balance of payments

According to the NBU, in 2014, balance of payments deficit surged to USD 13.3 bn or 10.1% of GDP (which is close to 2009 levels) from a surplus of 1.1% of GDP in 2013. Such drastic change occurred due to negative financial account balance. Overall deficit was financed by international reserves, which in 2014 fell more than twice to USD 7.5 bn.

Current account. Current account deficit shrunk to USD 5.3 bn or 4.0% of GDP (from 8.6% of GDP, in 2013) due to decline in merchandise trade deficit. In particular, imports of goods contracted twice faster than exports (see *Merchandise trade*). Hryvnia depreciation influenced both exports and imports; however, the direction of effect was different. Hryvnia depreciation supported exports, which also benefited from autonomous trade preferences by the EU. The positive impact, though, was weaker than the downward pressure from low external demand, especially, restricted access to the Russian market. In turn, hryvnia depreciation along with a decline in domestic demand resulted in sharp fall of imports. Positive contribution to the improvement of current account balance was made by lower deficit of primary account balance (deficit contracted by USD 1.7 bn to USD 1.3 bn). Lower net outflow of income was a result of lower return on foreign investments because of worse financial conditions of enterprises in Ukraine.

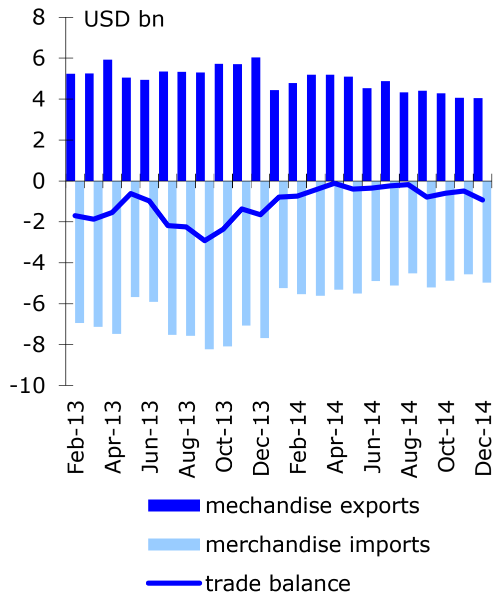
At the same time, trade in services and transfers negatively contributed to the current account balance. Surplus in services trade

Mobile market size



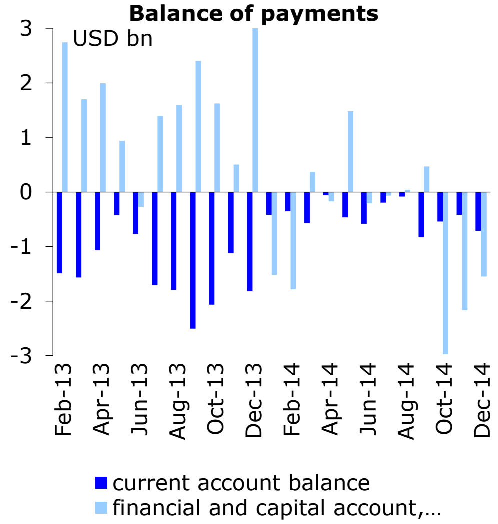
Source: NCCIR

External merchandise trade



Source: NBU preliminary estimates

Balance of payments



Source: NBU preliminary estimates

narrowed as exports dropped more than imports. In particular, tourism exports dropped due to high political and economic uncertainty, while gas transit dropped due to opened North stream (see *Energy*). Balance of transfers decreased because of lower inflow from abroad likely due to lower remittances from Russia explained by economic crisis in Russia as well as lower number of labour migrants that make transfer to Ukraine.

Financial account. Balance of capital and financial account turned to deficit at USD 8.0 bn. Capital account was balanced positive at USD 0.4 bn as Ukraine received financial support from its partners (e.g., European Union). On the other hand, political and economic instability led to worsening of the major components of financial account. Net inflow of FDI contracted from USD 4.1 bn to USD 0.4 bn as during the first five months of 2014 Ukraine experienced net outflow (see next subsection for details). Negative net portfolio investments in equity at USD 0.4 bn was explained by low confidence in Ukrainian securities due to worse fundamentals in 2014.

Overall balance of credit and bond operations turned from positive USD 7.3 bn in 2013 to negative USD 2.2 bn in 2014 as Ukrainian banks and real sector experienced restricted access to external financing due to much higher risk premium. Deficit of external financing was equal to USD 1.6 bn for banks and USD 4.1 bn for real sector, whereas in 2013 both of them had a positive balance of USD 0.7 bn and USD 1.9 bn, respectively. On the other hand, the Government was able to attract external financing from foreign governments and international organizations, as well as issue Eurobonds (see *State debt*). As a result, credit and bond operations of government sector were balanced at positive of USD 3.3 bn. Net repayment by trade credits was equal to USD 7.4 bn, including debt repayment by the Naftogaz to the Gasprom. Outflow of foreign cash currency from banking system was USD 2.7 bn, which despite sharp hryvnia depreciation, was equal to the previous year's figure.

FDI. Lower confidence of foreign investors because of political and economic instability resulted in tenfold contraction of net FDI inflow to USD 0.4 bn (NBU data). Such drastic changes were a result of FDI inflow drop from USD 4.5 bn to USD 0.5 bn. Moreover, FDI drop was driven by real sector as inflows to the banking system remained at USD 0.5 bn, which could be attributed to capitalization of banks by foreign owners. FDI inflow to the real sector decreased from USD 4.1 bn to almost zero. It should be noted that outward FDI decreased by fourfold to USD 0.1 bn.

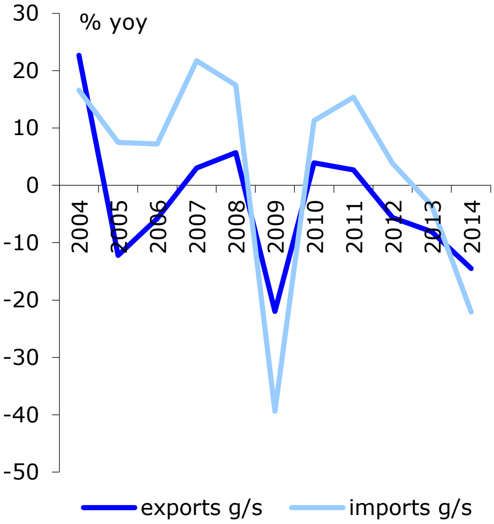
According to the Ukrstat, in 2014 the EU remained the main source of FDI to Ukraine (77.6%) with Cyprus accounting for 29.9% of FDI as of the end of 2014. 5.9% of FDI stock originated from Russia. Sector structure of FDI was dominated by industry (32.3% of stock as of the end of 2014), financial services and insurance (25.1%) as well as wholesale and retail trade (13.1%). The EU also dominated in FDI abroad with the share of 93.8% of total FDI stock (with Cyprus, off-shore, accounting for 91.6% of outward FDI stock) as of the end of 2014. Sector structure of outward FDI stock in 2014 was heavily dominated by professional services.

Merchandise trade: Exports and imports decreased significantly

According to the Ukrstat, merchandise trade turnover contracted by 22.8%. As imports dropped more than exports, merchandise trade deficit shrunk significantly from USD 13.7 bn in 2013 to USD 0.5 bn in 2014. Exports structure shifted from heavy industries to agri-foods, whereas imports one – remained dominated by heavy industries and minerals, but the role of agri-food increased. EU became the main trading partner.

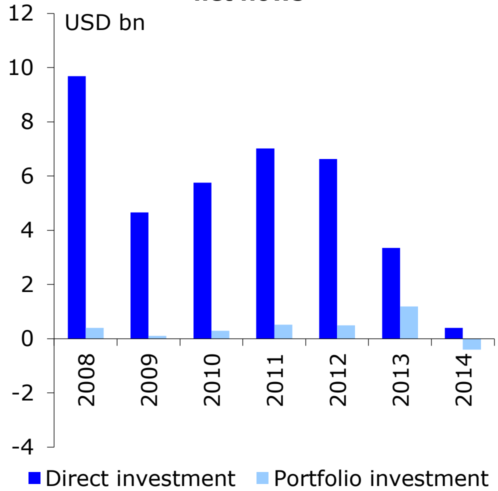
Merchandise exports. Despite hryvnia depreciation and autonomous trade preferences by the EU, Ukraine's merchandise exports contracted by 13.5% to USD 53.9 bn because of military conflict, restricted access to the Russian market, as well as

Real exports and imports



Source: Ukrstat

Foreign direct and portfolio investment net flows



Source: NBU

downward trend of world prices for commodities. However, exports drop was not uniform across product groups.

Exports of products of the Section I "Live animals and animal products" and Section IV "Prepared foodstuffs" decreased by 6.3% and 11.5%, respectively, as autonomous trade preferences only partially compensated lower access to the Russian market (see *Agriculture*). Exports of Section II "Vegetable products" decreased by 1.3% because of lower prices at international markets.

Exports of Section XVII "Vehicles, aircraft, vessels and associated transport equipment", Section XVIII "Instruments and apparatus" and Section XVI "Machinery and mechanical appliances, electrical equipment" decreased by 55.0%, 20.3% and 17.1%, respectively, due to restricted access to Russian market, key exporting market for machine building.

Exports of chemicals decreased as facilities located at occupied territories suspended production. As a result, shipments by Section VI "Products of the chemical or allied industries" and Section VII "Plastics, rubber and articles thereof" decreased by 23.8% and 25.3%, respectively.

Exports of goods under Section V "Mineral products" decreased by 15.1% mainly because of lower shipments of ore. Besides, suspension of production at some mines as well as reallocation to the domestic market led to lower exports of coal.

Exports of metallurgy produce (Section XV "Base metals and articles of base metal") decreased by 13.1% because of restricted access to raw materials extracted at the East, problems with logistics, as well as downward trend of world prices.

However, exports growth was reported for some products, including precious and semi-precious stones and metals (+36.4%), miscellaneous manufactured articles (+11.7%), wood and articles thereof (+10.4%), leathers, skins and articles thereof (+5.2%) as well as footwear, headgear, umbrellas (+2.1%). Exports of products of the Section III "Animal or vegetable fats and oils and their cleavage" increased by 9.3% due to autonomous trade preferences by the EU.

Merchandise imports. In 2014, merchandise imports dropped by 28.3%% to USD 54.4 bn. Drop in real disposable income resulted in decline in consumer demand for imports, while restricted financing caused drop in investment demand for imports. At the same time, hryvnia depreciation resulted in imports substitution. Downward pressure on imports was distributed more or less equally among different product groups. At the same time, imports of goods under Section XX "Miscellaneous manufactured articles" increased by 2.2%.

Significant contribution to overall merchandise imports drop was made by Section V "Mineral products" (-27.8%) as purchases of gas decreased significantly (see *Energy sector*).

Imports of agricultural and food products (Sections I-IV) decreased because of import substitution. The remaining imports, which includes mainly industrial production, contracted by 30%.

Trading partners. The EU became a key trading partner of Ukraine in 2014. Such changes occurred due to increase of merchandise exports to the EU (by 1.5%) and decrease to the CIS (32.5%). Merchandise imports from both trading partners declined (by 22.8% and 38.3%, respectively).

As a result, the share of exports to CIS countries declined by 7.2 p.p. to 27.6%, while share of imports from the CIS decreased by 4.6 p.p. to 31.7%. The share of the EU in exports grew by 5.1 p.p. to 31.5%, while the share of imports from the EU increased by 3.6 p.p. to 38.7%.

In terms of countries, Russia remained the largest trading partner of Ukraine (18.2% of exports and 23.3% imports). However, its share reduced substantially primarily due to trade tensions. Merchandise

Merchandise trade structure in 2014

	Exports		Imports	
	USD m	% yoy	USD m	% yoy
Total	**53914**	**-13.5**	**54382**	**-28.3**
I - Live animals, animal products	1015	-6.3	1123	-39.3
II - Vegetable products	8736	-1.3	2027	-22.3
III - Animal or vegetable fats and oils and their cleavage	3824	9.3	302	-25.2
IV - Prepared foodstuffs	3097	-11.5	2601	-18.2
V - Mineral products	6104	-15.1	16067	-27.8
VI - Products of the chemical or allied industries	3054	-23.8	6779	-19.4
VII - Plastics, rubber and articles thereof	586	-25.3	3635	-20.4
VIII - Leathers, skins and articles thereof	157	5.2	223	-13.1
IX - Wood and articles thereof	1263	10.4	295	-27.1
X - Pulp, paper, paperboard and articles thereof	986	-20.8	1289	-31.9
XI - Textile and textile articles	786	-2.9	1883	-21.6
XII - Footwear, headgear, umbrellas	203	2.1	431	-45.6
XIII - Articles of stone, plaster, cement, asbestos, glass	479	-17.7	801	-29
XIV - Precious and semi-precious stones and metals	161	36.4	297	-57
XV - Base metals and articles of base metal	15236	-13.1	3323	-32.9
XVI - Machinery and mechanical appliances, electrical equipment	5659	-17.1	8720	-26.4
XVII - Vehicles, aircraft, vessels and associated transport equipment	1472	-55	2648	-54.7
XVIII - Instruments and apparatus	232	-20.3	673	-37.4
XX - Miscellaneous manufactured articles	736	11.7	902	2.2
XXI - Works of art, collectors' pieces and antiques	0	-63.6	9	-62.2
Goods purchased at ports	10	-53.4	247	-11.7

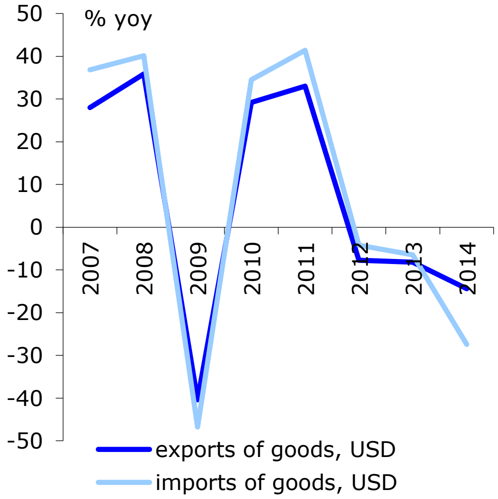
Source: Ukrstat

trade deficit with Russia in 2014 declined form USD 8.2 bn to USD 2.9 bn mainly due to low imports of gas.

Among the EU countries, the main trading partners of Ukraine were Germany, Poland and Italy. Poland was the main importer of Ukrainian goods (4.9% of exports), whereas Italy accounted for 4.6% and Germany – for 3.0%. At the same time, Germany was a key exporter from the EU, accounting for 9.9% of total Ukraine's imports, whereas Poland accounted for 5.6% and Italy – for 2.8%.

Share of Asia increased slightly by 0.3 p.p. to 26.6% of merchandise exports and by 0.1 p.p. to 19.8% of merchandise imports. Due to reallocations of trade from Russian market to the EU and decreasing significance of RU/CIS markets for Ukraine, Asia became more important in Ukraine's trade structure.

Merchandise exports and imports



Source: the NBU

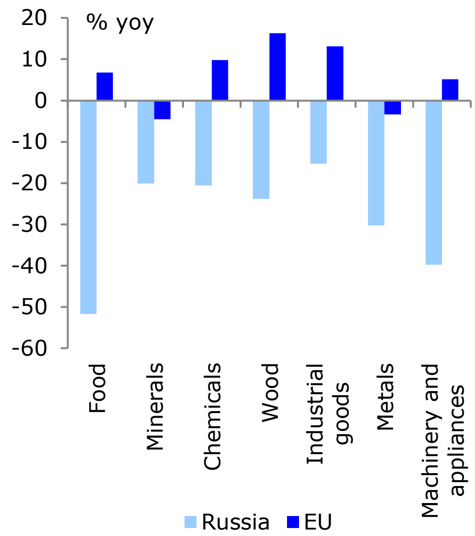
Trade policy: Closer to the EU, away from Russia

Trade policy in 2014 moved towards deeper integration with the EU.

European Union. In February 2014, newly appointed Government declared return to the path of Euro integration and confirmed its intensions to sign the Association Agreement with the EU. In order to support Ukrainian economy, which was hit by increasing political instability, in April 2014 the European Commission provided Ukraine with autonomous trade preferences (ATP), i.e. unilaterally opened its market for Ukrainian goods. In practice, ATP means application of import tariffs according to the first year of liberalization schedule envisaged in the AA, as well as providing imports from Ukraine with tariff-rate quotas (TRQs). 27 TRQs are served on "first come, first served" basis (including indentured ethyl alcohol, raw beet sugar, bran, sharps and other residues, grape juice, tomatoes prepared or preserved, wheat starch, glucose and fructose, etc.) and 10 TRQs on the basis on licensing (including common wheat, maize, barley, pork meat, poultry meat, etc.). However, not every Ukrainian exporter can be eligible for the liberalised access to the EU market. To favour from autonomous trade preferences Ukrainian enterprises have to receive Eur.1 movement certificate, whereas exporters without one (i.e., owing Certificate of Origin Form A) remained under the Generalized System of Preferences (GSP) regime.

On June 27, 2014, Ukraine and the EU signed the Association Agreement, which envisages bilateral liberalisation of trade in goods and services, as well as harmonization of horizontal and vertical legislation. Autonomous trade preferences were supposed to be in force until November 1, 2014, when the provisional application of Deep and Comprehensive Free Trade Area (DCFTA), included to AA, should have been started. However, because of pressure by Russia, implementation of the Association Agreement by Ukraine was postponed to January 1, 2016. As a result, autonomous trade preferences were prolonged for the remaining months of 2014 and entire 2015.

Exports to EU and Russia in 2014



Source: Ukrstat

Russia/RBK CU. The reaction of Customs Union of Russia, Belarus and Kazakhstan (RBK CU) on Ukraine-EU Association Agreement was not uniform. Whereas Belarus and Kazakhstan claimed that the DCFTA does not pose any threats for them and they are ready to deepen cooperation with Ukraine, Russia continued to put pressure on Ukraine to change or even cancel the Association Agreement. In early September 2014, Russian Government published its proposals on amendments to the AA, which tackled five issues:[xxxiii] excluding almost 20% tariff lined from Ukraine's liberalisation schedule, extensions from commitments on harmonization of technical regulations and standards as well as sanitary and phytosanitary measures, changes in customs-related provisions and energy sector.

As both Ukrainian government and European Commission rejected this proposal, on September 19, 2014, Russian Government passed a Decision 959 "On introduction of import tariffs for goods originating in Ukraine", which was drafted in the mid of summer 2014. According to this Decision, conditional on implementation of DCFTA by Ukraine, Most Favoured Nation (MFN) tariff rate will be introduced for a part of Ukraine's exports to Russia (approximately 12% of tariff lines, or 25% of value)[xxxiv]. Decision 959 was one the reasons Ukraine's implementation of DCFTA was postponed.

Trade tensions with Russia also took form of imports bans. During 2014 Russia banned imports of Ukrainian pork, cheese, potatoes, dairy products, and alcohol drinks. On the other hand, because of Russia's intervention, occupation and annexation of Ukrainian territories, Ukraine imposed restrictions on trade in weapons, military equipment and machinery, as well as dual-purpose goods with Russia.

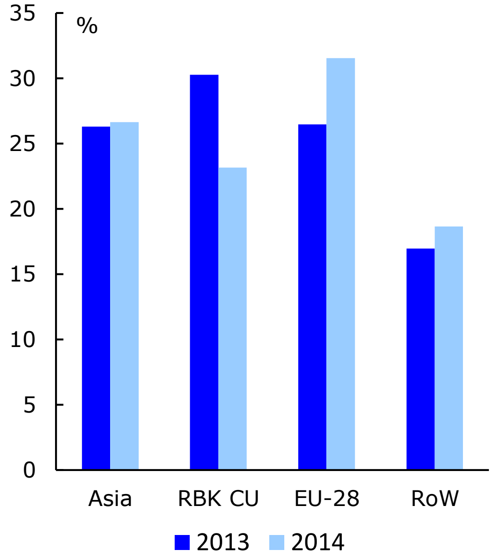
Additional import surcharge. At the end of 2014, in order to improve current account balance, the Parliament allowed the Government to introduce an additional import surcharge (for 12 months) at 10% for agricultural and food products (1-24 groups of HS classification) and 5% other imports regardless country of origin. Some mineral products and medicines were excluded from the surcharge. As these Laws[xxxv] contradicted Ukraine's commitments with the IMF and the EU, their implementation was to be postponed until all the consultations would be completed. However, the surcharge was introduced in the end of February 2015 before the completion of consultations.

Migration: At least 800 000 people fled Donbas and Crimea

Migration flows. The Russia's annexation of Crimea and the war in Donbas forced an outflow of people from those regions in 2014. According to the State Emergency Service, which was responsible for taking local residents out of the occupied territories in Donbas, the number of internally displaced persons (IDPs) was 614,500 as of December 27. Most of them fled Donetsk and Luhansk regions (594,500), a smaller portion left Crimea (19,900). Half of IDPs settled in Kharkiv, Dnipropetrovsk and Zaporizhzhia regions, as well as in government-controlled areas of Donetsk and Luhansk regions. In addition, according to the United Nations High Commissioner for Refugees, 590,500 people fled Ukraine (248,500 applied for refugee status or temporary asylum, and 342,000 applied for other forms of legal stay such as temporary or permanent residence permits),[xxxvi] and most of them moved to Russia.[xxxvii] However, those figures are likely to be incomplete because a number of IDPs did not inform authorities about leaving Donbas and Crimea. As of January 1, 2014, the total population of Crimea and the occupied territories in Donbas was 2.4 m and 3.8-4.0 m, respectively.

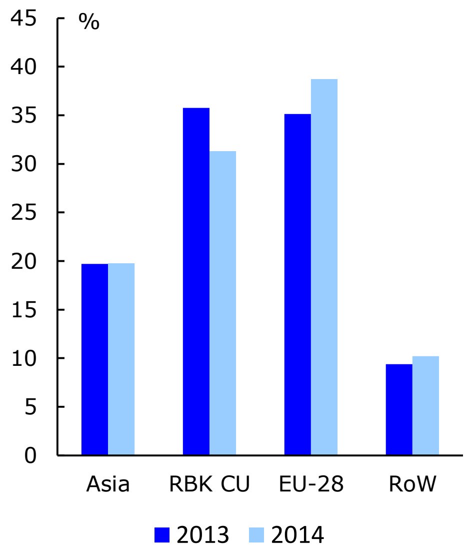
Regulation. In 2014, Ukraine boosted the implementation of the EU-Ukraine Visa Liberalization Action Plan (VLAP), which slowed down in the preceding year. In May, the Parliament passed a package of laws required by the plan. The laws were aimed at (1) enhancing protection of asylum seekers and providing them with free medical care, (2) fighting corruption (by modifying rules for disclosure of assets by public servants and changing procedures for public procurement), (3) eliminating discrimination on the labour market, and (4) enhancing data protection. The government and its agencies also adopted the necessary by-laws. Given those actions, the European Commission concluded that Ukraine met the benchmarks under the first phase of the VLAP (adoption of legislative, policy and institutional framework), and launched assessment of the second phase (implementation of the framework).[xxxviii] To meet the next set of benchmarks, Ukraine completed the preparation for issuing biometric passports (which started in the beginning of 2015). Ukraine also had to implement other measures, including enhancement of data protection, improvement of inter-agency information exchange, equipment of the border guard, and fighting organized crime. However, the implementation of these measures was rather slow. The completion of the second phase of the VLAP will allow the EU to lift the short-term visa obligations for Ukrainians.

Structure of merchandise exports



Source: Ukrstat

Structure ofmerchandise imports



Source: Ukrstat

Wages and income: Sharp drop in real wages

High inflation, difficult financial situation of companies, stable social standards and fiscal pressure resulted in the drop of real disposable income by 8.4%. Income from all components declined in real terms, except for other current transfers (this category includes remittances, insurance payouts, and fiscal transfers to households other than social assistance). Spending on loan interest and other paid transfers, i.e. insurance premiums, membership fees and outward remittances abroad increased reflecting changes in exchange rate. Nominal disposable income grew by only 2.6%.

Wage income declined by 8.6% in real terms due to decline in real average wage by 6.5% and increased unemployment (see *Labour market*). Real wage declined due restricted growth of nominal wage, high inflation and introduction of military fee as a surcharge to the PIT. Overall, nominal average wage grew by 5.9% due to partial indexation of wages for inflation and wage increases in companies with foreign currency income. Wage growth was restricted by small growth of minimum wage which was last increased in December 2013 (see *Social policy*). This factor was traditionally the key factor for wage increase especially in industry and public sectors. Wages declined in real terms for majority of employees. The smallest nominal increases in average wages were reported in public sectors (education, healthcare, state administration) due to high fiscal pressure, which wages frozen throughout 2014 as well as reduction bonuses and premiums for many public employees (primarily, civil servants). At the same time, employees in private services sectors such as trade, IT, transport, and professional services received higher wage increases that were close or outpaced inflation on average throughout the year (however, in the second half of 2014 real incomes dropped for most employees). Average wage in industry grew by 5.7% with the lowest growth recorded for machine building sector, which struggled due to low domestic and external demand (see *Industrial output*). Sectors that are traditionally oriented on domestic market, e.g. food, textiles and pharmaceuticals, were able to increase wages by more than 7%.

Income from social assistance and current transfers contracted by 7.3% in real terms as minimum pension remained fixed at the level of December of 2013. Increased interest rates on bank deposits and hryvnia depreciation supported property income (interest on bank deposits is the largest part of reported property income which also includes land rents and dividends). It declined by only 2.0% in real terms despite bank ran observed in 2014. Good harvest and likely stronger domestic demand for services and products of small proprietors (due to imports substitution) explain decline in real income from subsidiary farming and entrepreneurs' activity by only 0.6%.

Labour market: Hard times for finding a new job

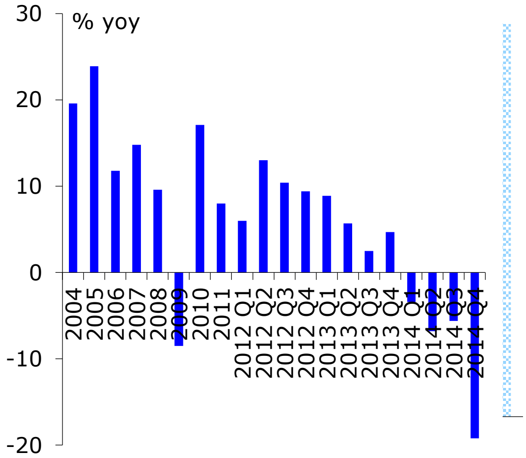
Unemployment. In 2014 unemployment rate (ILO methodology) reached 9.3% of economically active population in the age of 15-70 years old. This is by 2.0 p.p. higher than in 2013. Unemployment increased due to downturn in most sectors against the background of the war in the Eastern Ukraine and weak demand (see *GDP*).

Seasonal pattern of unemployment by quarters changed. Unemployment increased in the third quarter (to 9.5%), while this was usually a quarter with the lowest unemployment rate. In the last quarter unemployment reached 10.6%. Double-digit unemployment rate was last observed in the first quarter of 2002.

Unemployment rate increased significantly for men due to sharp decline in industrial output (see *Industrial output*) and construction. As a result, unemployment rate in 2014 was much higher for men than for women (10.8% and 7.5%, respectively).

Unemployment rate in rural and urban areas increased by near 2 p.p. to 9.5% and 9.2%, respectively. Higher unemployment in rural areas might be explained by higher share of low-skilled employees from

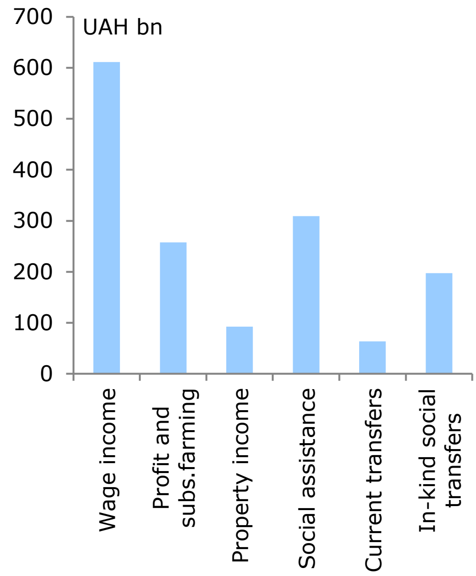
Real disposable household incomes



Source: Ukrstat

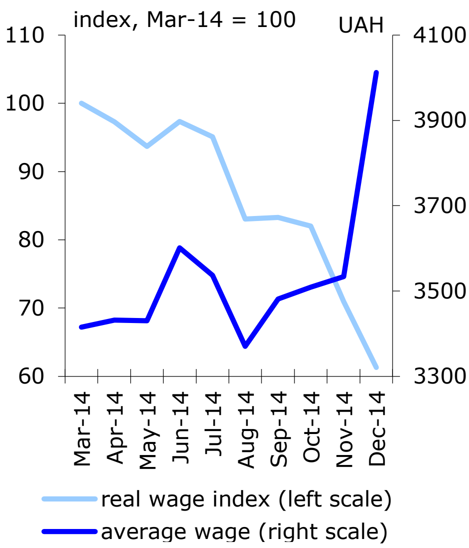
Source: Ukrstat

Households' income in 2014



Source: Ukrstat

Average wage*



*not including AR Crimea
Source: Ukrstat

rural areas, who are likely to be the first to be dismissed during the crisis.

Part-time and reduced employment. As in the 2009 crisis, companies in 2014 were reluctant to lay-off excessive labour employees and turned more to part-time employment. The average share of employees working reduced hours increased from 7.9% in 2013 to 9.9% in 2014[xxxix] (by 89 000 persons). Industry and transport had the largest share of employees with shortened working week (18.7% and 19.9%, respectively). Among industry subsectors, the most severely affected were manufacturing of electronic equipment (59.2% of workers were partially employed in 2014) and manufacturing of automobiles (52.7% of workers are partially employed). This is a consequence of a decline in production and already high partial employment in 2013 (at 37.4% and 39.3%, respectively).

Average number of employees on unpaid administrative leave in 2014 declined by 7 000 persons. Specifically, number of workers on administrative leave decreased by 9 500 workers in industry and by 5 300 persons in construction. Most likely, employees that were on administrative leave in 2013 were finally laid off in 2014 as business expectations worsened (see *Business climate - enterprises*). In other sectors number of employees on unpaid leave was insignificant.

Registered unemployment. Number of registered unemployed decreased from 470 000 persons in 2013 to 459 000 in 2014 regardless increase in unemployment rate reported according to the ILO methodology. Registered unemployment decreased both in terms of gender (by 2.6% for women and by 2.3% for men) and in terms of place of residence (by 5.3% for rural areas and by 0.6% for urban areas). This might be partially explained by difficulties in registering as unemployed of individuals from the occupied territories in Donbas and Crimea.

Fiscal Policy: High fiscal pressure required budget sequester

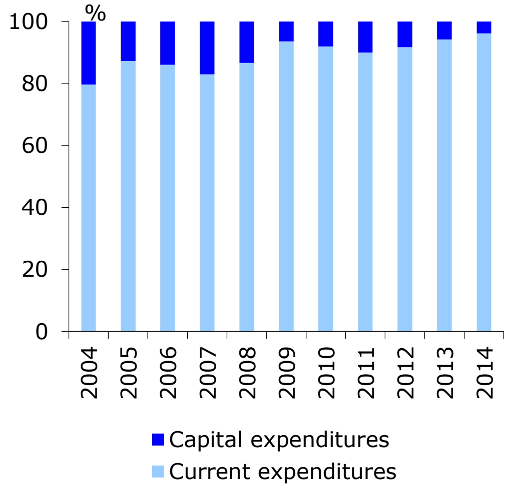
Fiscal policy was a core priority of the IMF Program and government's reform agenda. As part of the fiscal consolidation the Government increased taxes and tried to contain expenditures. This was explained by decline in revenues due to recession and need to increase spending for defence and security due to the war in the East.

Budget process 2014. On January 16, the Verkhovna Rada approved the State Budget Law for 2014.[xl] Central fiscal revenues and expenditures were set at 23.7% and 27.1% of officially forecasted GDP (UAH 392 bn and 447 bn, respectively). Central fiscal deficit at 3.6% of GDP was to be primarily financed at the expense of domestic borrowings. Fiscal indicators were based on optimistic macroeconomic forecast. In particular, real GDP growth was estimated at 3.0%. Overall, in the initial Budget Law the Government relied on expected funding from Russia to postpone overdue fiscal consolidation.

As economic outlook worsened and funding from Russia fell through, new Government had to sequester the budget among its first policy steps. Revised budget in March was a first step towards fiscal consolidation, which was one of the required prior actions to receive new IMF program (see *Politics*).[xli] Planned central fiscal revenues were reduced by 5.7% to UAH 373 bn reflecting new economic conditions. Revenues-raising measures such as higher excise taxes and resource charges and increased personal income tax were not sufficient to offset expected reduction in tax base (partially, due to annexation of Crimea). Planned central fiscal expenditures were cut by 8.8% to UAH 315 bn. Domestic financing of deficit was reduced due to low demand, while external financing was raised to take into account expected financial assistance from international donors.

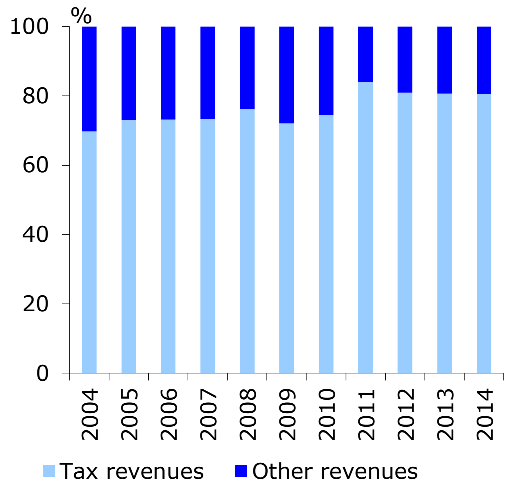
In particular, on the revenue side, the Government increased a number of taxes, including excise duty rates and rent payment rates.

Consolidated fiscal expenditures structure



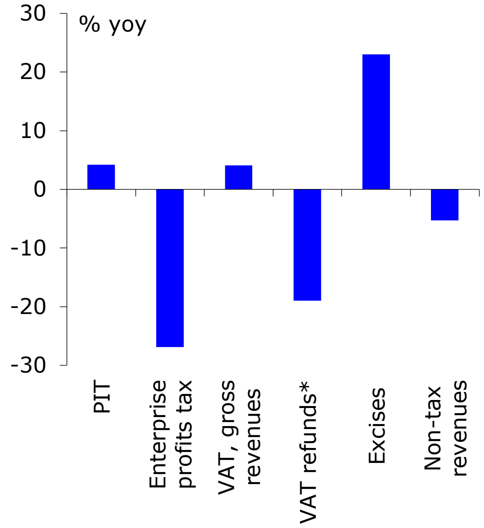
Source: State Treasury Reports

Consolidated fiscal revenues structure



Source: State Treasury Reports

Growth of Consolidated fiscal revenues in 2014



* cash VAT refunds (without VAT-bonds)
Source: State Treasury reports

Since April 2014 the pension duty on purchase of cash and non-cash foreign currency earmarked to the Pension Fund (with the rate of 0.5%) was reintroduced. Moreover, the Government increased progressivity of PIT by raising PIT rates for higher income. Besides, it raised taxation of passive income. In 2014 investment income was taxed at 15-25% (previously investment income was taxed at 5% as opposed to general tax rates of 15% and 17%). Such approach is justified as lower taxation of investment income was used by legal entities for minimisation of taxes (primarily payroll).

Taking into account high fiscal pressure the Government cancelled reduction of VAT rate planned for 2015 and reduced VAT exemptions. In particular, 7% VAT rate on medicines and medical products was introduced since April 1, 2014. To resolve the issue of overdue VAT refund arrears the Government renewed the practice to refund VAT at the expense of special issue of state domestic bonds (at UAH 7.0 bn).[xlii] Taking into account limited cash in government hands, this was a proper solution of the problem as it increased liquidity of exporters, who faced decline in revenues (see *Financial state of enterprises*).

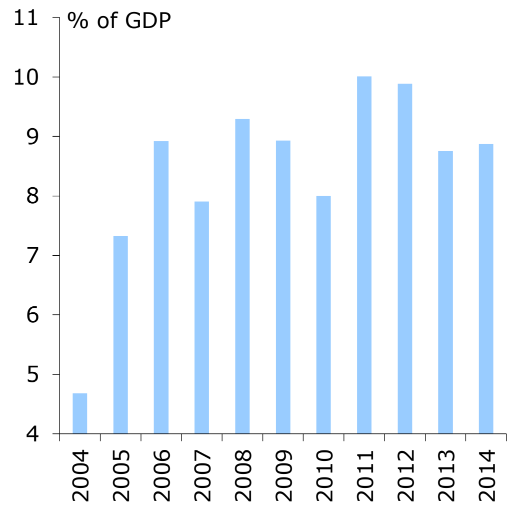
On the expenditures side, the Government reduced financing of most programs including social spending and capital outlays. Planned increase in subsistence minimum was cancelled, while some in-kind privileges became means tested and some social benefits were reduced (see *Social policy*). The Government also envisaged the reduction of number of civil servants (which was only marginally implemented in 2014). At the same time, the Government increased spending on housing and utility subsidies and introduced compensation of increased utility bill for the poorest households due to decision to increase gas prices for population (see *Social policy* and *Energy sector*). This, in turn, resulted in lower financing of the deficit of Naftogaz, though its support remained high primarily through recapitalisation at the expense of special issue of state domestic bonds (see *State debt*).

Next substantial revision of budget was in July. Fiscal indicators were changed to take into account lower than planned fiscal revenues and need to increase financing of defence and security items. The changes were also required to attain revised fiscal target of the IMF program. Overall revenues target was increased by UAH 4.9 bn to UAH 373 bn, while planned EPT and VAT revenues were reduced. In particular, to compensate for reduced tax base the Government increased rates of rent payments and excise and cancelled some tax exemptions. It and introduced 1.5% military fee as a surcharge to the PIT (the fee was to be effective only in 2014). The Government also introduced taxation of deposit interest requiring banks to deduct 15% tax from interest payments at the source. Effective VAT refund rules for agricultural exporters were extended until December 31 from October 1.

The Government also introduced large changes in VAT administration that became effective since January 1, 2015. Changes will require companies to pay VAT in advance, which is supposed to drastically reduce VAT fraud. At the same time, companies will no longer enjoy what was an essentially interest-free short-term loan from public purse and may have to face higher effective tax rates.

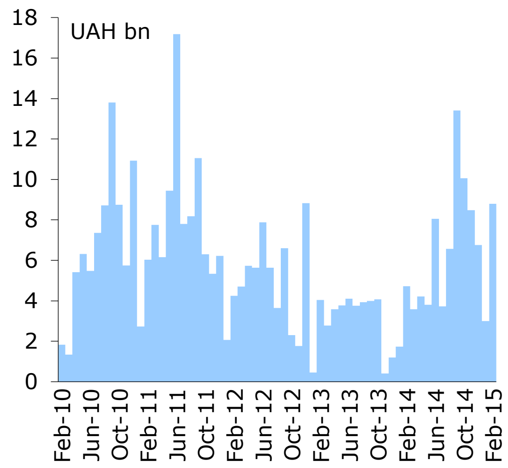
On expenditure side, non-security spending was cut again, which compensated for increased financing of security and defence items. In particular funding for a number of central executive bodies was cut as audits, inspections and other control measures by most state bodies without prior authorization by the Government were prohibited. The Government also cancelled premiums and bonuses paid to people's deputies, ministers and heads of other state bodies. The Government again committed to staff reductions in the state sector. The state aid to coal mining sector was reduced to take into account lost mines in occupied territories in the East and increased purchase price of coal.

Net VAT revenues



Source: State Treasury Reports

Balance of the Single Treasury Account



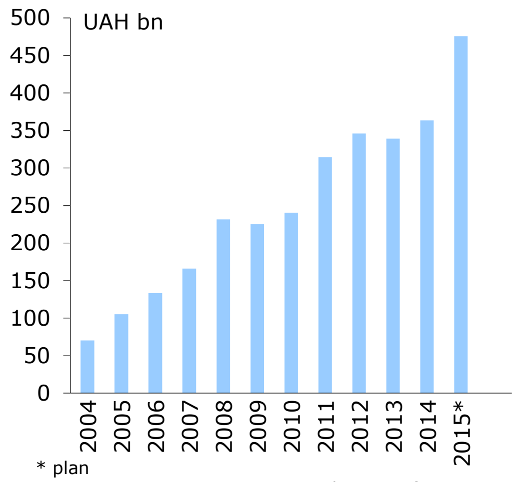
* in the beginning of month
Source: State Treasury

At the same time, plan of central fiscal deficit remained unchanged. However, the limit of state debt was increased from UAH 664 bn to UAH 807 bn as quasi-fiscal spending on recapitalisation of the Naftogaz and state-owned banks increased and debt in foreign currency increased due to hryvnia depreciation (see *State debt*).

Budget execution. Consolidated fiscal revenues in 2014 grew by 5.5% (excluding VAT refunds covered by special issue of state domestic bonds) thanks to hryvnia depreciation, accelerated inflation, and changed tax legislation. At the same time, adjusted for inflation revenues dropped by 7.3% due to Crimea annexation, war in the East and economic recession.

Hryvnia depreciation led to higher share of imports in tax base and accordingly higher revenues from VAT and excise duties from imported goods. Reduction in cash VAT refund also supported VAT revenues. Higher revenues from rent payments and excises were ensured by several hikes in rates. Revenues from VAT (net) and excise collection increased by 13.8% and 23%, respectively. PIT revenues grew by 4.2% as tax collected per taxpayer grew due to increase in gross wages and introduction of military surcharge, which compensated for sharp reduction of the number of taxpayers. At the same time, EPT collection dropped by 26.9% due to worse financial results of companies (see *Financial state of enterprises*).

Central fiscal revenues



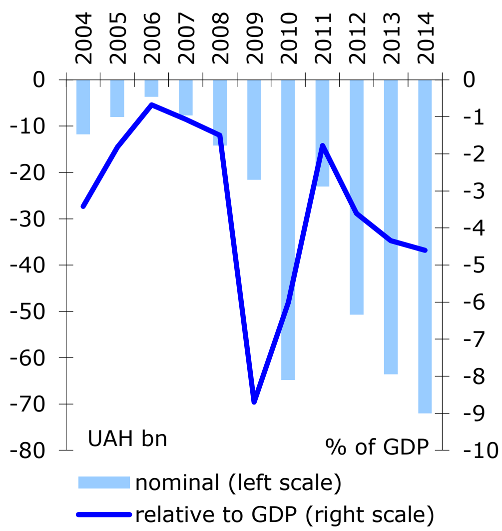
* plan
Source: State Treasury, State Budget Law for 2015

Non-tax revenues declined by 5.3%. In particular, transfer of NBU profits to the budget dropped by 19.4%. Harsh economic situation and lower revenues from occupied territories resulted in contraction of own revenues of budget entities by 16.7%.

Overall, consolidated fiscal revenues were by 6.6% lower than target. In particular, the Government was too optimistic on the expected outcomes of taxation amendments introduced in August 2014.

Delay in the IMF program and problems in Ukrainian financial sector limited access to financing and resulted in under-execution of consolidated fiscal expenditures by 11.3% of target. Still, nominal expenditures increased by 3.4%. In particular, consolidated fiscal deficit (without recapitalisation of the Naftogaz and state-owned banks) at UAH 72.0 bn was by 32.7% lower than target due to cancelled privatisation. As a result, capital spending were the worst affected (with 50% cut), which might undermine economic recovery in the medium run. Other discretionary spending were also cut, while security spending and nondiscretionary social spending items were financed close to the target.

Consolidated fiscal balance



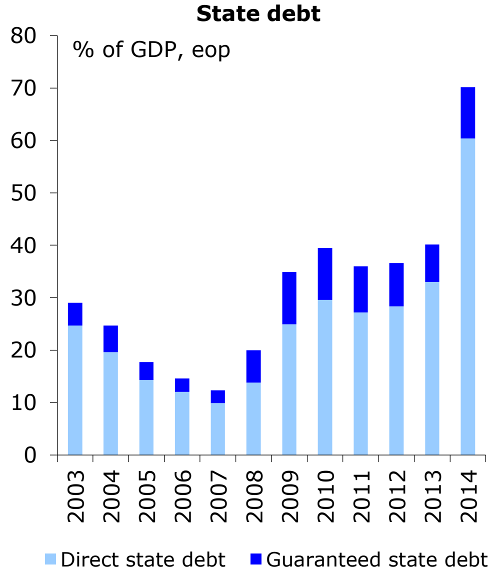
* without funds for recapitalisation
Source: State Treasury Reports

Administration. In 2014, the Ministry of Revenue and Duties was reduced in status to the State Fiscal Service (SFS), which is subordinated to the Ministry of Finance.[xliii] The key difference is return of policy-making responsibility to the Ministry of Finance, which is a justified approach.

State aid. The Parliament finally approved the State Aid Law[xliv] in 2014 that defines procedures for provision of state aid to avoid damage to competition and inefficient state spending. This is expected to end current situation, when state aid is often granted to favoured companies in an arbitrary manner. The Antimonopoly Committee is to become responsible for compliance with EU-imposed rules on provision of the state aid and to screen all regulations and draft laws that are intended to provide some benefits to companies or sectors of economy for their effect on competition. Transition to new rules will be gradual and it will be fully implemented only in three years. Hopefully, the institutional capacity of the Antimonopoly Committee strengthen by that time, as currently it exhibited limited independence and weak institutional capacity.

Approval of the Budget 2015. The Parliament approved the State Budget Law for 2015 at 5 A.M. of December 29. The Budget is based on numerous amendments of the Tax and Budget Codes and other legislation. Central fiscal revenues plan at UAH 476 bn is somewhat optimistic as it implies increase in revenues by about 31% as compared to actual indicator for 2014. Main sources of revenues growth include higher tax rates of rent payments and excises, somewhat larger tax base, increase in PIT rate for taxing passive income to 20% and redistribution of revenues to central budget, i.e. 25% of PIT revenues (and 60% of PIT collected in city of Kyiv) will be due to central budget. Military fee was made permanent. The Government also envisaged introduction of 5-10% surcharge on imports after consultation with the EU and the IMF. Besides, transfer of the NBU profit to the central budget is to increase to UAH 65.4 bn as compared to UAH 22.8 bn in 2014.

On the positive side of tax amendments, the Parliament approved some reductions in tax burden through harmonization in application of similar taxes and simpler accounting standards for EPT calculation. This might facilitate business operations. The changes on the payment of single social contribution were also made. In particular, companies increasing wages by at least 30% from average wage in 2014 with resulting average wage in company higher than 3 minimal wages were allowed to apply lower than regular rates of the single social contribution (SSC).



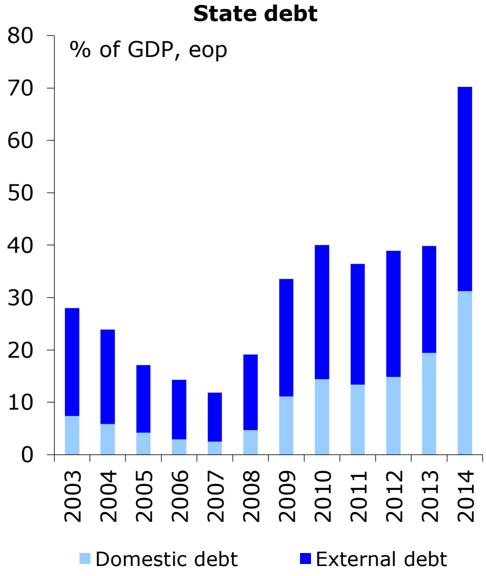
Source: Ministry of Finance

Central fiscal deficit is planned at UAH 63.7 bn or 3.7% of GDP (based on official GDP forecast). Privatisation receipts are again planned at UAH 17 bn, which might be executed only under assumption of higher economic and political stability in the country. At the same time, general government deficit estimated according to the IMF methodology is planned at near 6% of GDP. In particular, the Government envisages special issues of state domestic bonds to recapitalise the Naftogaz and energy companies, step in several commercial banks (if they do not increase their capital as required), and provide financing to the Deposit Guaranteed Fund.

On the expenditure side the Government increased financing of defence and security items. At the same time, it somewhat streamlined social assistance through making welfare policies more targeted to poor and eliminating some privileges.

State debt: Record high level of state debt

In 2014, hryvnia depreciation, economic recession and increased military spending exacerbated the problem of debt sustainability. Total state debt (direct and guaranteed) almost doubled, reaching UAH 1100 bn. It increased in relation to GDP from 40.2% to 70.3%.[xlv] The share of external debt grew by 4.2 p.p. to 55.6% due to hryvnia depreciation and financial support from official international donors.



Source: Ministry of Finance

Domestic borrowings. State domestic bonds outstanding increased by 81.3% yoy to 458 UAH in the end of 2014 due to new issues of bonds as well as hryvnia depreciation.[xlvi] Bonds were issued mostly for recapitalization of state-owned banks, the Naftogaz and the Deposit Guarantee Fund, as well as for covering VAT refund arrears. The demand for other bonds (issued for budget financing) was primarily divided between short-term and mid-term bonds (43.1% and 44.9% of the total placement respectively).[xlvii] The amount of USD- and EUR-denominated bonds placements significantly decreased due to low demand and high cost for the Government due to volatile exchange rate.[xlviii] They were predominantly short-term.

In 2014, the Government further increased statutory capital of state enterprises and banks. In particular, the Government issued special state domestic bonds for recapitalization of the NJSC Naftogaz at UAH 96.6 bn, the Oschadbank at UAH 11.6 bn and the State Export-Import Bank of Ukraine at UAH 5 bn. The Cabinet of Ministers provided the loan for the Deposit Guarantee Fund in the form of special state domestic bonds issue at UAH 10.1 bn. As most recapitalization bonds appeared in the NBU portfolio, the NBU holdings of the state domestic bonds surged by 11.2 p.p. to 69.5% of total state domestic bonds outstanding, while the banks' share dropped from 32.1% to 20.4%.

In 2014, the Ministry of Finance again issued special state domestic bonds to cover VAT refund arrears (at UAH 6.9 bn). The bonds were issued for 5 years at 9.5% p.a. with semi-annual coupon paid along with 10% of principal (partial redemption of the VAT bonds in an amount of 10% of their nominal value).[xlix]

Moreover, the Government issued UAH 20 bn of state domestic bonds to reimburse the NBU for repaying budget support received from the IMF under the SBA arrangement of 2010.

External borrowings. Gross external borrowings grew by 83.1% in hryvnia equivalent in 2014 due to hryvnia depreciation and international financial assistance programs launched in April.

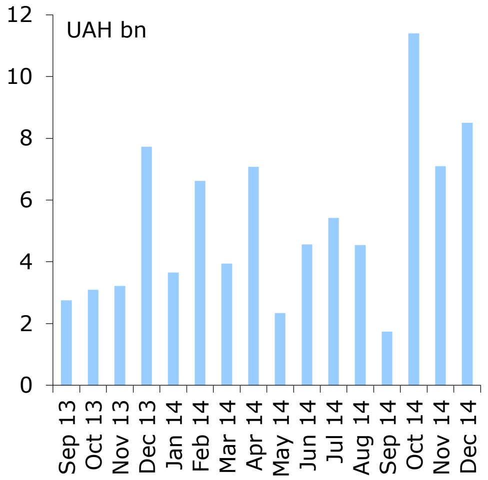
In particular, the Government received two tranches of USD 4.6 bn (out of total USD 17.0 bn) from the IMF under two-year Stand-By Arrangement (SBA) to support Ukraine's economic reform program. Besides, EU provided EUR 1.4 bn to Ukraine within two EU macro-financial assistance loan programs (at EUR 1.6 bn) aimed at supporting structural reforms to ensure sustainable economic growth and sound financial situation.

The World Bank granted USD 1.3 bn in the framework of the first development policy loan for institutional reforms and implementation of the anti-crisis management program in Ukraine's financial sector. The funds were provided for sixteen years with seven-year grace period at floating rate (0.63% p.a. as of the signing date).

In May, the Ministry of Finance placed USD 1 bn of five-year Eurobonds supported by the loan guarantee agreement between the governments of Ukraine and the USA. Assistance to Ukraine was also provided by governments of Canada and Japan (USD 200 m and USD 100 m, respectively).

Summing up, large international financial aid package to Ukraine helped the Government to timely and fully service its debt. However, restoration of debt sustainability requires further steps in the framework of fiscal consolidation.

State domestic bonds placements in UAH (without recapitalisation)



Source: NBU

Social policy: Frozen social standards

Social standards and minimum wage. Subsistence minimum (SM) and, as a result, minimum pension and minimum wage in 2014 remained at the level of December 2013. In particular, the Government in March cancelled increases in subsistence minimum planned for July and October as part of fiscal consolidation measures (see *Fiscal policy*).[l] Due to sharp acceleration in inflation, social standards in real terms declined on average by 5.8% in 2014 and 24.9% yoy in December 2014. Social assistance to low-income families also was frozen in 2014 as the amount of assistance is defined as a share of subsistence minimum. At the same time, minimum pensions and social assistance within subsistence minimum was indexed by officially reported inflation.

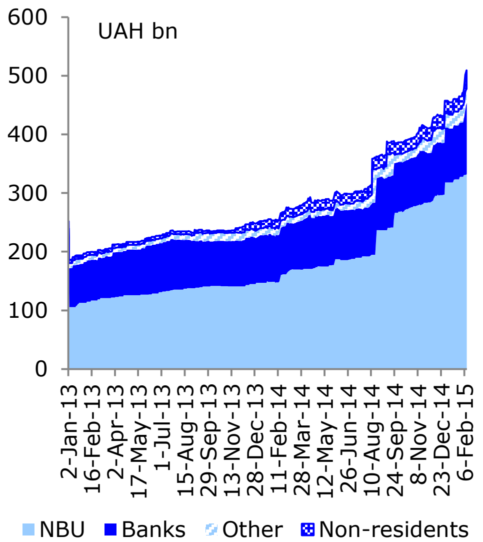
Social assistance. In-kind privileges to several groups of public sector employees (judges, police, etc.) became more means-tested. Only those employees with average per capita family income lower than 1.4 subsistence minimums are eligible for privileges that are envisaged in legislation.

Besides, since July 2014 the Government reduced social assistance to families with children. In particular, the size of birth grants was unified at UAH 41280 or 40 SMs at a current rate (before it was 30 SMs for the first child, 60 SMs – for the second child, 120 SMs – for more children). It will be paid during three years regardless number of children, while before it was paid during two or six years. At the same time, the payment of assistance for caring child up to three years old was cancelled.

Subsidies. In 2014 the Government attempted to shield poor households from the impact of increased housing and utility tariffs (see *Energy sector* and *Utilities*).

First, in July the Government started paying special compensation to households with per capita income below subsistence minimum. The

Domestic government bond holdings



Source: NBU

payment covered full difference in utility bill of households before and after hikes in tariffs for gas, electricity and heating. It was complementary to usual housing and utility subsidy, which was provided to households with spending on housing and utility bills above 15% of their income (10% for households comprised without able-bodied individuals). The compensation was envisaged for the heating season of 2014/2015, after which another wave of changes in housing and utility subsidies was envisaged.

Then, since October 1, the Government introduced amendments in provision of housing and utility subsidies. It introduced new social housing and utility usage caps instead of previous standards. These caps were defined for housing size, use of gas and water, electricity consumption for the provision of subsidies. If household uses more water or electricity than provided in usage cap extra payment is excluded from utility bill subject to subsidies. At the same time, the Government changed the formula for the calculation of share of housing and utility bill over which the household becomes eligible for the subsidy. Previously state guaranteed with subsidies that utility bill will not exceed 15% of household income if usage of utility services do not exceed limits. Difference was covered by the subsidy. Now maximum utility payment after which subsidies kick in varies with income. Households with per capita income at the level of subsistence minimum will spend no more than 7.5% of their income on utility bill if they apply for subsidies. Middle income earners at 4 subsistence minimums per person will have to spend over 30% of their income on utilities to be eligible for subsidy. New formula is aimed to make housing and utility subsidies more targeted to poor households and, thus, reduce leakage to richer households. However, real value of subsidies is eroded if social standards grow slower than inflation and there is risk of excessive burden of utility payments for poor but not extremely poor households.

Social security system. On December 28, 2014, the Verkhovna Rada decided to combine the Fund of Compulsory Social Insurance in Case of Temporary Loss of Ability to Work and the Fund of Compulsory Social Insurance in Case of Occupational Disease and Accident at Work into one Social Insurance Fund. This decision is expected to reduce administrative spending and eliminate duplicate and extraneous functions that were performed by previous funds. In particular, the Parliament has already cancelled several unjustified functions of funds, including payment for spa treatment of insured individuals and their children as well as financing of health resorts and sanatorium.

East. In October, the Government suspended social assistance payments, including pensions to people that live in the occupied territories of Donbas. To receive pensions and welfare payments the respective persons should register on the territory controlled by Ukraine.[li] According to the Ministry of Social Policy information, large share of pensioners registered on the controlled territory and receive their payments.

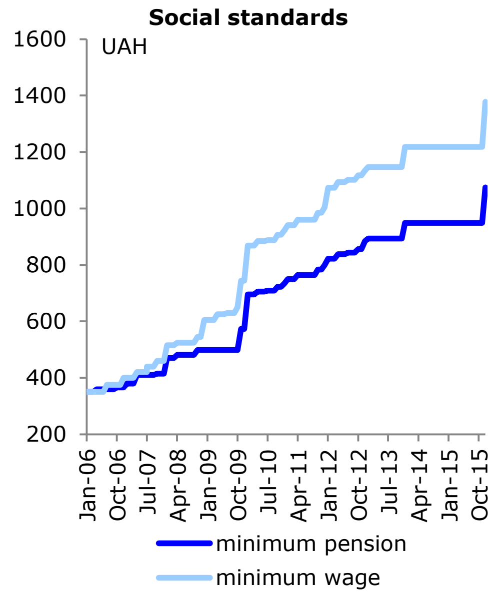
At the same time, the Government introduced social welfare payments for people that left occupied territories at UAH 884 for working non-able household members and UAH 442 per working able members.[lii] The maximum welfare payment per one household is set at UAH 2400 per month. The payment could be paid for six months at maximum. If able-bodied individuals do not work after two months after registration their welfare payment is reduced by 50% for next two months and then cancelled. Such criterion is aimed at reducing free-riding behaviour. At the same time, it is getting more difficult for such people to find job taking into account weak labour market in all regions of Ukraine (see *Labour market*).

Social standards in 2015. According to State Budget Law for 2015 subsistence minimum will be increased only in December 2015 as the Government attempts to contain growth of pension liabilities and reduce fiscal pressure during economic recession. In December 2015, the subsistence minimum for all demographic groups and

Subsistence minimum, UAH

	Jan./ Nov. 2013	Dec. 2013/ Nov. 2015	Dec. 2015
General level	1108	1176	1330
In particular:			
For children less than 6 years old	972	1032	1167
For children of 6-18 years old	1210	1286	1455
For working able individuals *	1147	1218	1378
For individuals that lost ability to work**	894	949	1074

Note: * minimum wage
** minimum pension
Source: the State Budget Laws for 2013, 2014, 2015



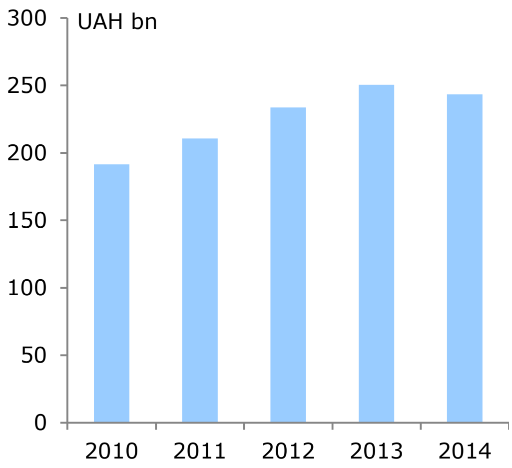
Source: State Budget Laws for 2006-2015

correspondingly minimum wage is planned to be increased by 13.1% yoy. Taking into account expected inflation, purchasing power will reduce further, which would limit consumption and hamper economic recovery.

Pension system: The pension reform is on its way

Planned budget. The budget of the Pension Fund for 2014 was approved by the Cabinet of Ministers only on June 25, 2014 due to difficult economic situation and political uncertainty.[liii] Fund's deficit was envisaged at UAH 18.1 bn, which was to be financed at the expense of the central fiscal transfer. The central fiscal transfer for financing state pension programs, including special pensions and supplement for pensions to the guaranteed minimum, was foreseen at UAH 65.7 bn.

Expenditures of the Pension Fund



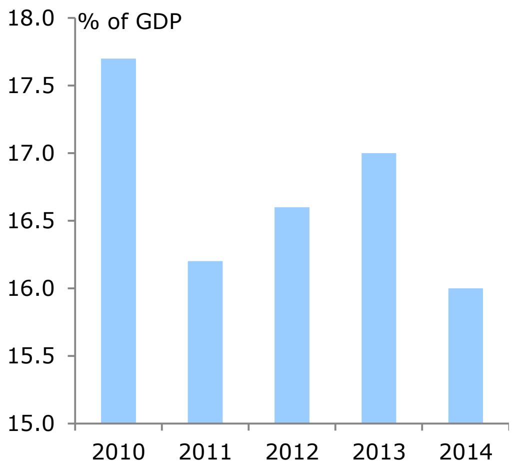
Source: Pension Fund

During the year the Government has tried to solve the problems with shortfall of cash in the State Budget and the budget of the Pension Fund. In particular, the Parliament allowed the Government to redistribute funds from unified social contribution between social security funds. This decision allowed the Government to reduce planned central fiscal transfer to the Pension Fund by UAH 2.1 bn to UAH 81.7 bn. In turn, the Pension Fund received UAH 2.0 bn that were earmarked to the Unemployment fund and the Social insurance fund in case of temporary working disability.[liv] This limited funds available for active and passive labour market policies by the State Employment Centre.

Execution of the budget. According to the Pension Fund, own revenues of the Pension Fund (primarily receipts from unified social contribution due to the Fund) were by UAH 1.0 bn or 0.6% lower than planned. Revenues were likely supported by somewhat higher gross wage bill than officially expected as the Fund did not receive UAH 5.1 bn from employers from occupied territories in Donbas. Own revenues accounted for 71.9% of total Fund's revenues.

At the same time, central fiscal transfer was by UAH 5.9 bn or 7.2% lower than planned (with under-executed transfer for financing special pension programs as well as for deficit financing). In particular, central fiscal transfer for deficit financing was by UAH 2.4 bn lower than planned likely due to saved funds for paying pensions to pensioners in occupied territories in Donbas (see *Social policy*). At the same time, the deficit was partially financed at the expense of the Treasury's loan at UAH 1.0 bn. Overall deficit amounted to UAH 15.8 bn.

Expenditures of the Pension Fund



Source: Pension Fund

Expenditures of the Pension Fund in relation to GDP remained high, even though they reduced by 1 p.p. to 16% of GDP due to fixed minimum pension (see *Social policy*). Average old-age pension was equal to UAH 1428 per month or by 50.5% higher than minimum pension. Still, 58.6% of pensioners received supplement to their pension as their earned pension was lower than minimum pension. The Government spent on this supplement payment UAH 32.3 bn (that comprise 13.3% of the Pension Fund's expenditures).

Legislative changes. On December 28, the Parliament approved amendments to pension legislation. Special pensions to judges, prosecutors, civil servants and people deputies were lowered from 70% to 60% of final salary (60% instead of 80% of scientists).[lv] This is expected to contain growth of central fiscal transfer to the Pension Fund in the future as well as increase fairness of the system. The early retirement scheme for people who became unemployed 1.5 years before retirement age was eliminated. Moreover, pensions not subject to PIT tax were reduced 3 minimum wages (UAH 3654) (before 10 minimal wages).[lvi]

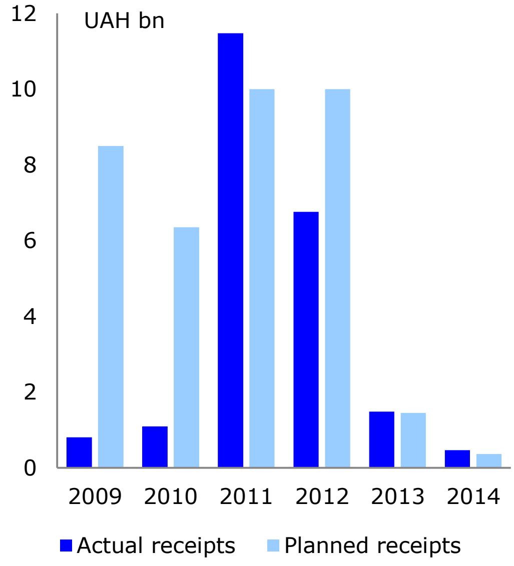
Privatisation: Unfulfilled plans

In 2014, privatisation receipts amounted only to UAH 467 m, which comprised only 2.7% of initial ambitious target for the year. The annual target was revised downwards to UAH 363 m only in

November, when it became clear that privatisation would not be successful due to high economic and political uncertainty.

According to the initial plan, the Government wanted to privatize 164 stakes with market value UAH 15 bn (according to the SPFU's estimation). But later, on July 11th, the Sumykhimprom, Turboatom, Ukrnafta and some other attractive companies were excluded from the list.

Privatisation receipts



Source: SPFU

Business climate - enterprises: Negative assessment with no expected changes in 2014

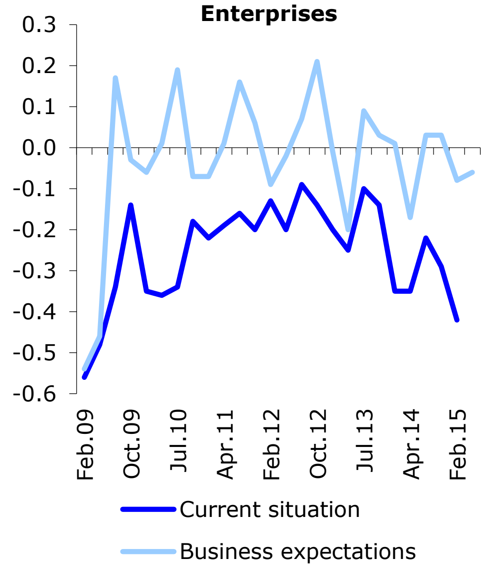
Overall business climate. According to the IER quarterly enterprise survey[lvii] managers of industrial enterprises assessed the overall economic situation in Ukraine mostly negatively in 2014. While expectations changed from pessimistic to neutral the indicators of the current situation assessments remained below zero throughout the year.

The first quarter of the year marked the biggest deterioration of the evaluations of business climate, which is explained by annexation of Crimea and beginning of the military conflict in the East (see *Politics*). The value of the index of business climate assessment decreased from -0.14 in October 2013 to -0.35 in February 2014. In April, the index stayed at the same -0.35 mark. Some improvement of business climate assessments was reported in July 2014 with the index rising up to -0.22. However, in October 2014 the index dropped again as 40.9% of industrial enterprises considered economic situation in the country unfavourable. Only 6.4% assessed business climate positively, and the remaining enterprises assessed it neutrally.

The index of business expectations, which shows the respondents' expectations about the changes in the overall economic situation in the next six months, was -0.17 in February 2014 (as compared to 0.01 in October 2013). For the rest of the year, enterprises did not expect worsening of the situation but were not optimistic either. In April and July, the index of business expectations was 0.03 and 0.01, and in October 2014 it dropped slightly down to -0.08.

Impediments to business development. Over the year 2014, low demand was a critical impediment for production growth as reported by Ukrainian industrial enterprises. However, towards the end of the year, the share of the firms affected by political instability almost matched the share of those with low demand. Lack of liquidity was also a major challenge for enterprises throughout 2014.

Indices of Overall Business Climate: Enterprises



Source: IER Survey

Two out of three polled enterprises named lack of demand as the factor that inhibits their development in each quarter of 2014. Low demand tops the list of the impediments for production growth, including the latest survey.

Towards the end of the year, unstable political situation moved to the second position of the barriers ranking. The impact of this impediment increased substantially since 2013, when it started playing an important role (in the fourth quarter of 2013 the share of enterprises that mentioned political instability as a key impediment surged to 27.2% (from 9.6% in the third quarter) due to the beginning of the Euromaidan protests in Ukraine).

Limited access to funds constrained business development at least for half of polled companies. Banking lending was restricted also by unaffordable interest rates. In particular, the negative impact of high interest rates spiked in the middle of the year, when 44.7% of the enterprises named this as one of the major impediments for their development.

Moreover, near a third of the firms faced shortage of raw materials, which might be at least partially attributed to disruption of supply chains due to annexation of Crimea and military conflict in the East. In 2013, the share of enterprises that faced this impediment ranged from 16.2% to 33.1%.

At the end of 2014, excessive taxation was an obstacle for business development for 24% of industrial firms. The impact of this factor fell in 2013, with the share of the polled firms that faced this obstacle falling from 54.9% in the 1st quarter to 33.4% in the 4th quarter of 2013.

At the end of year inconsistent energy supply was reported as an essential impediment for business operation. In particular, the percentage of the enterprises that faced energy supply problems increased from 3.6% in the 1st quarter of 2014 to 16.7% in the 4th quarter.

At the same time, fewer enterprises report the negative impact of competition and government regulations at the end of 2014 than at the beginning of the year. Namely, the share of the firms that faced unfavourable regulatory climate reduced from 35.7% in the 1st quarter of 2014 to 24% in the 4th quarter. Likewise, the share of the enterprises experiencing high competitive pressure dropped from 34.7% in the 1st quarter to 23.1% in the 4th. Such changes are likely to be explained rather by more striking negative impact of other factors, than improvements in regulatory climate and lower corruption.

Impediments to production growth

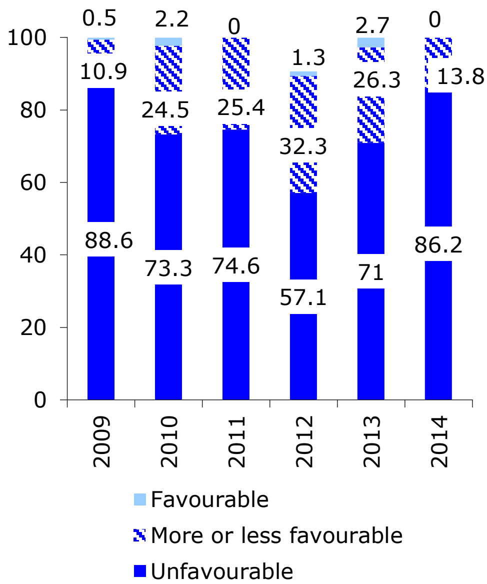
	Q1 14	Q2 14	Q3 14	Q4 14
Low demand	63.8	62.7	58.3	62.5
Unstable political situation	47.1	43.3	45.9	58.3
Liquidity problems	53.9	57.9	50	54.2
Shortage of raw materials	29.2	33.6	27.7	32.7
High interest rates	19.3	44.7	35.7	26
Excessive taxation	21.4	32	30.3	24
Unfavorable regulatory climate	35.7	23.9	28.7	24
High competitive pressure	34.7	29.6	31.8	23.1
Problems with energy supply	3.6	4.8	13.7	16.7
Access to credits	20.1	15.2	14.6	11.5
High regulatory burden	**26.4**	**16.4**	**20.1**	**13.8**
Changes in economic legislation	**9.7**	**6.4**	**9.6**	**10.9**
Corruption	**5.5**	**5.1**	**6.4**	**5.8**
Outdated technologies	7.5	6.8	11.5	5.4
Shortage of skilled workforce	8.1	4.6	6.7	4.5
Shortage of capacities	1.9	3.1	2.5	4.2

Source: IER Survey

Investment activity. At the beginning of 2014, 44.5% of the managers of industrial enterprises said they were ready to invest in 2014[lviii]. The percentage of such enterprises increased as compared to 2013 when 40% of the enterprises planned to invest. However, the percentage of the firms that made investment in 2014 was 36.3%, which is less than the share of those that invested in 2013 (46.5%). Overall, capital investments declined by 24.1% (see *Investments*).

The situation is unlikely to change substantially in 2015 as 86.2% of enterprise managers assess investment climate in 2015 as unfavourable (as compared to 71% of managers in 2014). This is illustrated with the share of the respondents who consider the year 2015 "unfavourable for the purchase of equipment", which is the indicator that measures investment environment. The major obstacles for investment activity, as reported by the enterprises in the 1st quarter of 2015, are insufficient income (for 55.1% of the enterprises), unstable political situation (46.9%), and difficult access to loans (33.3%).

Is it a favourable time for investment?, % of firms



Source: IER survey

Financial state of enterprises: Recession is gaining momentum

Dramatic events that took place in Ukraine in 2014 heavily affected enterprises (see GDP). As a result, consolidated financial resultlix turned negative at UAH 408 bn as compared to positive figure of UAH 38.3 bn in 2013. Overall, all sectors, except for agriculture and education, finished year with negative financial results. Share of loss-making companies increased by 5.5 p.p. to 40.1% of all enterprises. The main factors that contributed to this are disruption in supply chains and logistic problems due to military conflict in the Eastern Ukraine, increased input prices, and lower demand.

Among all sectors, industry suffered the most (see Industrial output). Its result changed from positive at UAH 18.5 bn in 2013 to negative at UAH 152 bn in 2014. This is primarily the result of coal mines closure in Eastern Ukraine and large drop in the demand for automobiles and other machines. Losses of oil processing and coke production sector were caused by the closure of several plants in the war zone and difficulties in obtaining raw materials. Pharmaceutical sector was the only industrial sector with positive result in 2014 (though it still fell by 34.9%). This is explained by the government procurement and imports substitution.

Agricultural companies reported not only positive, but improved financial result (increase at 18.6% to UAH 12.9 bn in 2014. Share of companies with negative financial result also decreased by 5.8 p.p. to 16.5% of agricultural enterprises. Such a good results were attributed to good harvest and positive situation on export markets (see Agricultural production).

Monetary policy: (Quasi) fiscal blues

According to policy documents the NBU in 2014 continued gradual move to inflation targeting as it did over the last 5-10 years. However, in 2014 unlike in the previous years, the NBU did have some progress in this regard. NBU monetary policy operations became more effective and there were improvements in the institutional structure and communications. The NBU still had to intervene on foreign exchange market both by selling and buying dollars and through administrative measures. Huge size of quasi-fiscal operations with government bonds, disruption of interbank credit market due to bank failures, limit on bank refinancing outside of rescue policy limited role of monetary policy.

Overall, the NBU withdrew UAH 84.5 bn of liquidity through interventions on foreign exchange market and UAH 16.5 bn through NBU deposits facility. However, government bonds held by NBU and loans to government increased by UAH 189 bn and loans to banks grew by other UAH 33 bn. Some of the hryvnia funds provided by the NBU to the government never left the public sector as they were used to purchase foreign currency from the NBU. Nevertheless, impact of fiscal and bank rescue operations by the NBU was far larger than the one of monetary policy operations. In particular, three policy rate increases that brought NBU discount rate from 6.5% p.a. to 14% p.a. and tighter reserve requirements for banks had limited impact on monetary conditions.

Overall monetary conditions were not very tight for some banks in 2014. Healthier banks had sufficient liquidity and overall banking sector liquidity was stable throughout the year. Deposit and lending interest rates increased slower than inflation. However, bank sector lost part of deposits and lending activity dropped.

Money supply grew by 9.5% yoy in December 2014 mostly due to change in valuation of foreign currency deposits and higher cash outside banks. Bank deposits and securities in hryvnia dropped by 13.6% yoy in response to bank runs and failure of several banks. In sum, monetary policy in 2014 was dominated by fiscal operations that injected liquidity in economy. However, impact of extra liquidity was limited due to structural problems in banking sector.

Inflation: Consumer inflation at 25% yoy

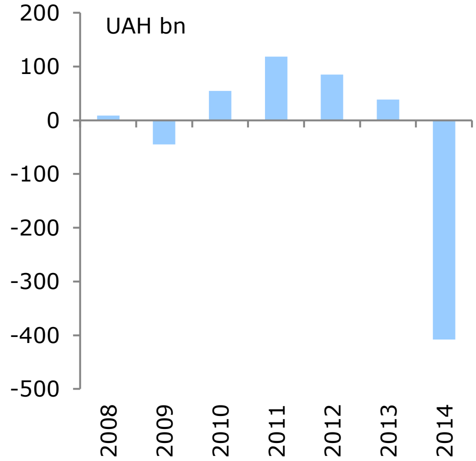
Inflation accelerated from -0.3% on average in 2013 to 12.1% on average in 2014. In December 2014, CPI growth was even faster at 24.9% yoy. Price growth for individual goods diverged significantly. According to the Ukrstat, vegetable prices decreased by 11% yoy in December, while prices for rice, buckwheat, fruit, gasoline and cars jumped by 60-120% yoy.

Depreciation of hryvnia was the prime reason for return of double-digit inflation after several years of price stability. Hryvnia exchange rate changed from UAH 8 per USD in February 2014 to UAH 16 in December (see *Exchange rate*). This increased prices for imported consumer goods, energy costs and prices for other imported inputs. Grain prices went up in line with export earnings. Depreciation of hryvnia also formed high inflation expectations. This led to higher (nominal) domestic margins, price increases for good and services with low import contents.

The Government also increased prices for natural gas, heating, electricity and water for household by 10-60% in response to higher costs. Overall increase in housing costs reached 34.3% yoy in December 2014.

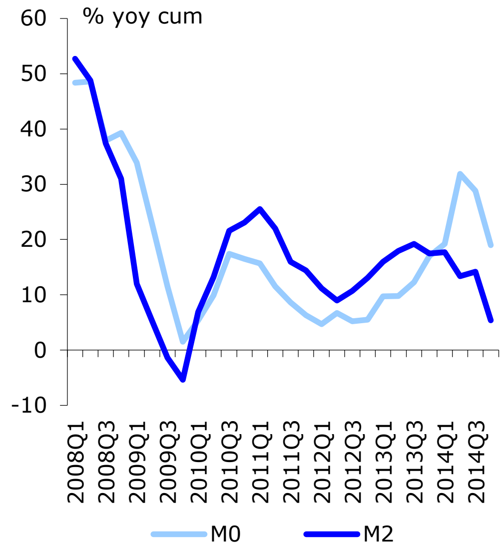
However nominal consumer demand grew by less than 6% in 2014 as unemployment increased, wages in private sector grew slowly, pensions and public sector wages were frozen. This restricted price increases for goods with higher elasticity of demand contained labour costs. For example, prices for household appliances increased by

Consolidated financial result of Ukrainian companies



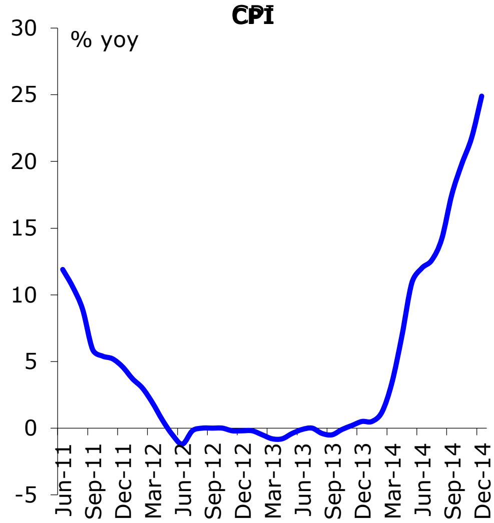
Source: Ukrstat

Monetary aggregates



Source: NBU

CPI



Source: Ukrstat, NBU

28% yoy (~90% imported in retail sales) in December 2014, while prices for pharmaceuticals (~50% imported} grew by 45% yoy[lx]. Prices for services, where key expense was labour, grew in single digits.

Falling or stable global commodity prices also helped contain inflation. FAO food price index fell by 10% yoy in December 2014, while crude oil prices were stable for the first three quarters of the year and went down sharply in the rest of the year (from USD 100 to USD 60 per barrel of Brent oil).

Core inflation was at 22.8% yoy in December 2014. It was close to headline figure as low prices for vegetables were offset by faster growth of prices for gasoline and utility tariffs.

Overall, inflation returned very quickly in 2014. Although exchange rate pass-through was initially moderate, the degree of depreciation was large and the inflation crossed 20% mark. As exchange rate volatility continued throughout the year, inflation expectations went up and sensitivity of consumer prices to exchange rate increased. This was one of the factors of even higher inflation in 2015.

Exchange rate policy: Downward spiral

UAH/USD interbank exchange rate remained generally stable between 2009 and 2013, although the NBU had to spend large part of international reserves and to introduce administrative measures defending the peg. This meant that hryvnia was significantly overvalued by the end of 2013. In January and February 2014, the NBU spent additional USD 3.6 bn defending exchange rate as political instability increased depreciation expectations and allowed hryvnia to move closer to UAH 9 per USD. Hryvnia was allowed to depreciate without NBU interventions in late February and continued weakening in March and April. Floating exchange rate was one of the conditions of the IMF program received by the Government in April.

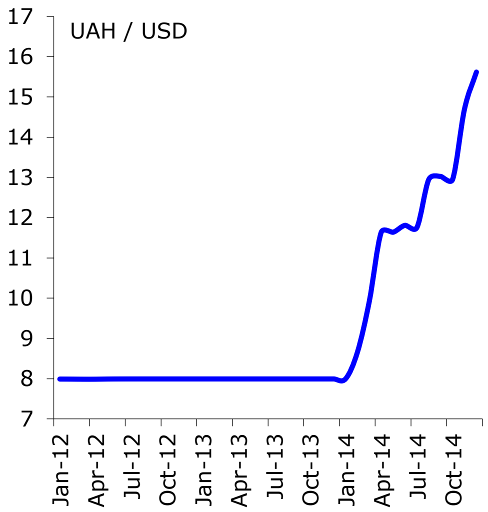
As hryvnia weakened to over UAH 12 per USD in April, the NBU extended and widened administrative measures to stabilize hryvnia. At the same time, depreciation was sufficient to bring current account closer to balance (see *Balance of payment*). This happened even as conflict flared up in Eastern Ukraine. Hryvnia remained stable over summer but political infighting delayed inflows from the IMF, while the NBU had to accumulate reserves to satisfy conditions of the IMF program. As a result, depreciation expectations strengthened, while exports dropped in response to war in the Eastern Ukraine. After the first review of the IMF program was complete on August 29 the NBU had more flexibility to influence the exchange rate.

In September and October, the NBU attempted to keep the exchange rate at UAH 13 per USD using combination of enhanced administrative measures (including among others restrictions on cash foreign currency purchases, 100% mandatory sales of FX inflows, restriction on transfer of equity and income of investments in Ukraine) and foreign currency interventions. However, current account inflows continued to go down, official funding slowed, while foreign currency public debt service payments remained high. Administrative restrictions were undermined by black market and semi-legal transactions.

In the end of October, the NBU eased restrictions on business foreign currency payments and reduced interventions. International reserves were falling and export revenues continued on downward trend. As a result, hryvnia fluctuated in UAH 15-16 per USD range on the interbank market. "Grey" market rate (i.e. exchange rate for payment card transactions or exchange rate including "commissions" from sellers to buyers of foreign currency) was closer to UAH 18-19 per USD by the end of the year.

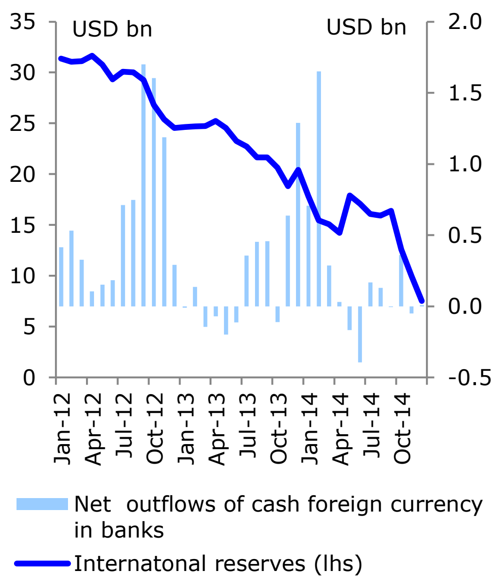
In 2014, depreciation expectations resulted in withdrawals of USD 9.1 bn of private foreign currency deposits. This was one of the key pressures on the exchange rate, while official cash foreign currency purchases were relatively low due to administrative measures.

Official exchange rate



Source: NBU

NBU international reserves



Source: NBU

Administrative measures also resulted in low liquidity of interbank foreign currency market forcing the central bank to intervene just to balance supply and demand fluctuations.

Overall, the NBU spent USD 9.4 bn in interventions to support exchange rate in 2014 (although part of the spending simply transferred funds from international donors to Naftogaz). Payments of foreign currency public debt interest and principal in 2014 exceeded inflows. Indeed, most (SDR 2.39 bn out of SDR 2.97 bn) of the IMF funds received in 2014 were used to repay the IMF the debt under previous programs. As the result, NBU international reserves were down to USD 7.5 bn by the end of 2014 as compared to USD 20.4 bn in the end of 2013.

Financial markets: Uncertain future of financial sector

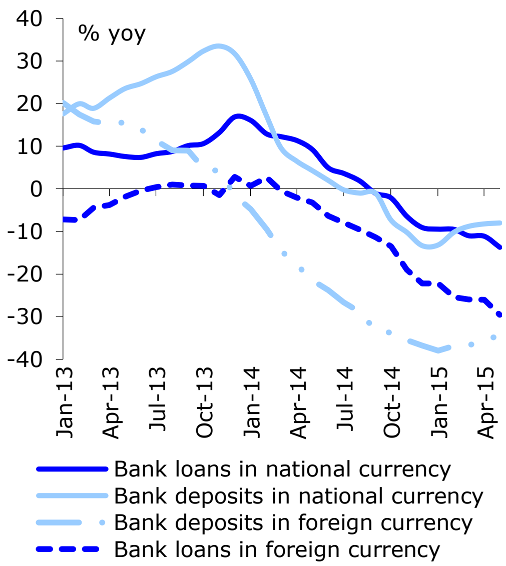
Stock market. Stock market was not very active in 2014. Stock operations moved from stock exchanges to off-the-market (OTC) transactions after excise tax on OTC transactions was cancelled in the end of 2013. Stock market turnover dropped from UAH 45 bn in 2013 to UAH 24 bn in 2014. Even on the stock exchanges large part of activity was likely related to "junk" operations, i.e. tax planning or evading currency controls. Five of top-10 stocks by turnover were owned by offshore companies related to Privat group and were traded on Prydniprovska stock exchange, which is a part of Privat group. Several of these companies reported only securities transactions as economic activities and number of operations with these stocks was over hundred times lower than for other top-10 stocks. Thus, decline in stock market activity in 2014 was likely larger than headline figures show.

Insurance market. In 2014, number of insurance contracts with individuals and with legal entities dropped by 59% and by 53%, respectively. This likely reflected high elasticity of demand for insurance services. At the same time, net insurance premiums dropped only by 14%, reflecting increase in prices of insured items/compensation sums. Auto insurance remained the largest business line for Ukrainian insurers (at UAH 6 bn or 32% of net premiums). Here, insurers were able to preserve premiums at the level of previous year as number of insured cars dropped mostly in Eastern Ukraine and Crimea, while car value in hryvnia went up on average by 35% according to the Ukrstat. Medical insurance was the only line of insurance with increased premiums (by 6%). As a result, net premiums for medical insurance reached 10% of the total. This likely reflected continued demand for services of insurance companies as managed care providers: two thirds of earned premiums were paid out as insurance compensation in 2014. Increase in prices of healthcare provided (according to the Ukrstat, CPI for healthcare increased by 16.5% in 2014) was also a factor. At the same time, demand for "financial" insurance dropped sharply in line with drop in lending activity.

Overall, insurance companies seem to have weathered the crisis in passable condition. Total assets of non-life insurance companies on bank deposits or invested in government securities were UAH 10.6 bn or over two times the insurance pay-outs in 2014. This would point to sufficient liquidity of healthier insurance companies.

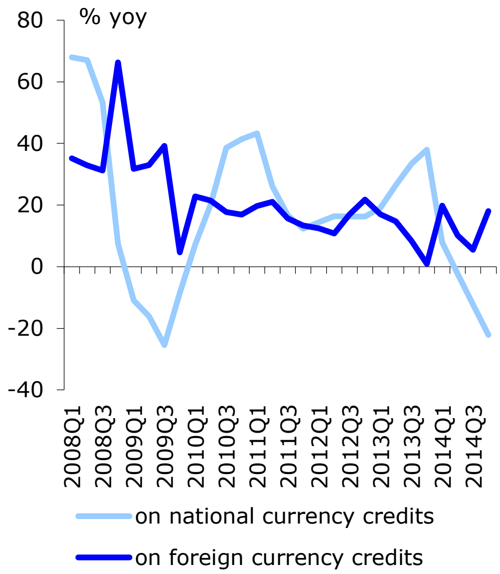
Banking sector. 2014 was a hard year for Ukrainian banks. Ukrainian banking system faced a number of challenges. First, many Ukrainian banks had large exposure to Donbas and Crimea. Over 10% of loans to Ukrainian banks and even larger share of collateral was located there. Conflict in Donbas led to very sharp drop in economic activity in Donetsk and Luhansk oblast (by over 50% in Donetsk and by over 80% in Luhansk) with the corresponding impact on borrower's ability to pay. In part this was offset by frozen deposits. However, deposits will eventually have to be paid. Second, companies from other regions also faced slump in cash flows contributing to problem loans. Depreciation of hryvnia, high inflation and slow growth of incomes strained finances of households. In all this led to sharp increase in problem loans. Problem loans

Growth of bank loans and deposits



Source: NBU

Household deposits



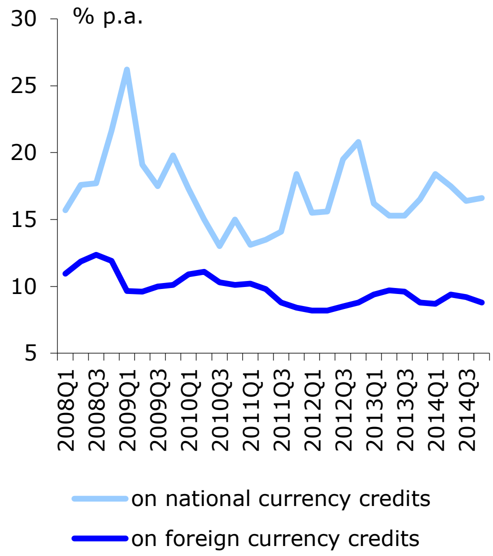
Source: NBU

acknowledged by banks reached 25% of gross loans in the first quarter of 2015[lxi] as compared to 13% in the end of 2013. Third, mass withdrawals of bank deposits undermined bank liquidity. Healthier banks that could provide sufficient collateral received NBU refinancing and later improved cash flows. Still, healthier banks (defined as not liquidated or under administration as of July 7, 2015) lost 15% of household deposits in hryvnia and over 30% of household deposits in foreign currency in 2014. Fourth, less scrupulous banks owners scrambled to get out of problem banks and left them with almost empty shells. Fifth, banks in 2014 continued to service external debt while they had even more limited access to external funding.

In combination these challenges and NBU efforts to "clean up" the banking sector from banks used in tax schemes, money laundering and capital flight led to total of 51 bank failures in 2014 and first half of 2015 (all banks that failed in 2015 were designated as problem banks in 2014). These banks represented 22% of bank sector assets in the beginning of 2014. Nevertheless, majority of larger banks remained in business and were successfully recapitalized to offset some of the losses from non-performing loans. Banking system did not collapse and almost all household depositors in the failed banks received full compensation from the Deposit Guarantee Fund (small minority had deposits over UAH 200 000). After several years of external debt repayments, bank loans are now mostly funded by domestic source. At the end of 2014, domestic funding of healthier banks was at 94% of loans.

Still, financials were weak for most banks. Weak lending activity, fierce competition for scarce deposits and substantial operating costs mean that even healthy banks produce too little operating cash flow to cover loan losses. As a result, operating losses of healthier banks (defined as net interest and commission income less loan losses and administrative costs) reached UAH 51 bn in 2014.

Average lending rates



Source: NBU

Notes

i According to the Crimean authorities, 83.1% of voters participated in the referendum, and 96.8% of them voted to join Russia. But according to Mustafa Dzhemilev, a leader of the Crimean Tatar community, in fact only 32.4% of voters attended the referendum.

ii Production of locomotives and railway carriages dropped by 65.7%.

iii http://avm-ua.org/index.php?action=dairynews&id=9624

iv http://www.apd-ukraine.de/images/APD_AFPR_05_2014_ukr.pdf

v Law of Ukraine, № 771/97-вр, from 01.01.2015 http://zakon3.rada.gov.ua/laws/show/771/97-%D0%B2%D1%80

vi Law of Ukraine, № 1648-18, from 14.08.2014 http://zakon2.rada.gov.ua/laws/show/1648-18

vii Law of Ukraine, № 0431-14, from 01.04.2014 http://zakon4.rada.gov.ua/laws/show/z0431-14

viii Law of Ukraine, № 1193-18, from 09.04.2014 http://zakon2.rada.gov.ua/laws/show/1193-18

ix http://forbes.ua/ua/business/1369118-skilki-agrariyi-zaoshchadyat-na-skasuvanni-sertifikaciyi-zerna

x Resolution of the Cabinet of Ministers of Ukraine, № 442-2014-п, from 03.04.2015 http://zakon4.rada.gov.ua/laws/show/442-2014-%D0%BF

xi Law of Ukraine, № 87-19, from 13.01.2015 http://zakon3.rada.gov.ua/laws/show/87-19

xii http://ukraine-eu.mfa.gov.ua/ua/ukraine-eu/trade-and-economic/atm

xiii http://www.apd-ukraine.de/images/APD_AFPR_01_2015_eng.pdf

xiv Law of Ukraine, № 71-19, from 28.12.2014 http://zakon4.rada.gov.ua/laws/show/71-19 xv http://mpe.kmu.gov.ua/minugol/control/uk/publish/article?art_id=244984286&cat_id=35081

xvi Data for 11 months of 2014.

xvii Coal purchases from the South Africa were disrupted due to the accusations of low quality and high price of the coal.

xviii The Law of Ukraine #663 "On the Principles of the Electricity Market of Ukraine" as of October 24, 2013

xix Iryna Kosse. The European model of energy market will promote free competition and attract investments. http://www.ier.com.ua/en/publications/comments/?pid=3411

xx CMU Decree, No.1071, from July 24, 2013. http://mpe.kmu.gov.ua/fuel/doccatalog/document?id=260994

xxi The gas prices decreased in the beginning of 2014 due to the gas deal with Russia signed by Azarov Government. However, after the Revolution of Dignity Russia greatly increased the price of gas from Q2/2014 and after Ukraine refused to accept the new terms, supplies of the Russian gas stopped till December. Ukraine purchased gas from Europe which was more expensive than the initial price of Russian gas so domestic prices for gas started to increase. Overall, the marginal price of gas in 2014 doubled compared to 2013.

xxii All data without Crimea and Sevastopil

xxiii http://zakon3.rada.gov.ua/laws/show/z0832-14/paran9#n9

xxiv The Ukrstat.

xxv http://zakon4.rada.gov.ua/laws/show/z0663-14

xxvi Yearly Report of the NCCIR for 2014

xxvii http://nkrzi.gov.ua/index.php?r=site/index&pg=148&language=uk

xxviii http://nkrzi.gov.ua/index.php?r=site/index&pg=150&language=uk

xxix Yearly Report of the NCCIR for 2014

xxx Yearly Report of the NCCIR for 2014

xxxi Law of Ukraine "On amending certain laws of Ukraine on improving energy payments" #1198-VII of 10.04.2014

xxxii Annual Report of NERC for 2014

xxxiii http://zn.ua/POLITICS/rossiya-trebuet-chtoby-soglashenie-ob-associacii-ne-meshalo-tyanut-ukrainu-v-ts-152725_.html

xxxiv http://pravo.gov.ru/proxy/ips/?docbody=&nd=102358617&intelsearch=%EF%EE%F1%F2%E0%ED%EE%E2%EB%E5%ED%E8%E5+959

xxxv Law of Ukraine No 73-VIII of December 28, 2014 "On measures to stabilize the balance of payments of Ukraine in accordance with Article XII of GATT-1994"

Law of Ukraine No 74-VIII of December 28, 2014 "On amendments to the Customs Code of Ukraine to stabilize the balance pf payments"

xxxvi http://korrespondent.net/ukraine/3461766-v-ukrayne-kolychestvo-pereselentsev-prevysylo-610-tysiach-chelovek

xxxvii http://www.unhcr.org/548190aa9.html

xxxviii Fourth Report on the implementation by Ukraine of the Action Plan on Visa Liberalisation.

xxxix 2014 data does not include AR Crimea, so comparison between years is only approximate

xl Law of Ukraine, No.719-VII, from January 16, 2014.

xli Law of Ukraine, No. 1165-VII, from March 27, 2014.

xlii Special issues of state domestic bonds were used to settle the problem of overdue refund arrears in 2004 and 2010.

xliii CMU Resolution, No.160, from May 21, 2014.

xliv Law of Ukraine, No. 1555-VII, from July 1, 2014.

xlv According to the IMF, average state debt level for emerging market economies was estimated at 39.7% in 2014.

xlvi According to the NBU.

xlvii However, the share of bonds with maturity up two years grew substantially compared to previous year (by 26.9 p.p. from 16.2% in 2013).

xlviii From USD 5.3 bn and EUR 112 m in 2013 to USD 793 m and EUR 40 m in 2014 respectively.

xlix Similar special state domestic bonds issues (at UAH 16.4 bn) aimed at covering VAT refund arrears were already done in 2010. The bonds also carried semi-annual 5.5% p.a. coupons.

l According to the State Budget Law for 2014, which was approved on January 16, subsistence minimum and, as a result, minimum pension and minimum wage were to be increased by 8.1% on average in 2014 (or by 6.8% in December-on-December terms).

li CMU Resolution, No. 509, from October 1, 2014.

lii CMU Resolution, No. 505, from October 1, 2014.

liii CMU Resolution, No.202, from June 25, 2014.

liv Law of Ukraine, No.1622-VII, from July 31, 2014.

lv Law of Ukraine No.76-VIII, from December 28, 2014.

lvi Law of Ukraine No.71-VIII, from December 28, 2014.

lvii http://www.ier.com.ua/ua/publications/regular_products/business_idea_industry/

lviii According to the results of the special study of the investment activity of enterprises conducted in the beginning of 2014

lix The financial results of companies as reported before EPT is paid (source: Ukrstat).

lx This in part reflected introduction of 7% VAT for medical products and medicines.

lxi Delays and incentives against recognizing problem loans would mean that most of the non-performing loans(NPLs) reported at the end of March 2015 were NPLs in the end 2014/

Tables

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

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

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

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INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING PRODUCTS

Monthly Economic Monitor Ukraine (MEMU) with supplement

The MEMU contains a monthly review and brief analysis of the key economic policy measures and data that come public during the previous month. The MEMU supplement presents extended analysis of one key event in the Ukrainian economy. There are 12 issues per year disturbed among subscribers.

Macroeconomic Forecast of Ukraine (MEFU)

The MEFU includes forecast of the GDP and its components, fiscal indicators, balance of payments, inflation, exchange rate for current and next years. There are 12 issues per year – 4 quarterly issues and 8 updates with short comments – disturbed among subscribers.

Infrastructure Monitoring of Ukraine (IMU)

The IMU is an annual report that presents information on the restructuring of six key infrastructure sectors of the Ukrainian economy in a standardized manner, which allows for cross-industry comparisons. Monitored indicators are qualitative and fall into three broad categories: (1) commercialisation, (2) tariff reform, and (3) regulatory and institutional development. Twenty-one indicators allow for economic and policy-making analysis at different aggregation levels. It is distributed free of change.

Economic Summary for Ukraine

Economic summary is a review and brief analysis of the key economic indicators and policy measures of the year. It is published in January using the available statistics and annual estimates and updated in May when the most of previous year data becomes publicly available. The product is distributed among subscribers.

Business Tendencies Survey

Business Tendency Surveys are comprised of two surveys. The first one – Industries – is prepared on the basis of quarterly surveys of industrial enterprises managers. The second – Banking – is based on the survey of banks managers. There are four publication for each of the component of the Business Tendencies available and participants of the surveys and to subscribers.

Policy Papers

The policy papers are the joint product of the German Advisory Group for Economic Reforms in Ukraine and the IER aimed at providing economic policy recommendations to Ukraine's policy makers. The recommendations are based on the careful analysis of Ukraine's situation, state-of-the-art economic theory, and best international practices. The papers are available for policy makers and – with some time lag – for general public.

Notes:

avg average
cum. cumulative
mom month on month change
qoq quarter on quarter change
yoy year on year change

ytd year-to-date
p.a. per annum
eop end of the period
aop average of the period
gs goods and services