



Monthly Economic Monitor Ukraine

No.8 (166), August 2014

EXECUTIVE SUMMARY

HIGHLIGHT: BUDGET AMENDMENTS

Politics: Early Parliamentary election is expected in October as ruling coalition was formally disbanded in the Parliament.

Real Sector: Real GDP declined by 4.7% yoy in the second quarter of 2014 according to preliminary Ukrstat estimate. This likely reflects falling investment and slowdown in consumption growth.

Energy sector: To compensate for lack of the Russian gas imports Ukrainian government takes steps to replace gas imports and decrease gas consumption.

Agriculture: Ukraine exported a record 32.2 m tonnes of grains in the 2013/2014 marketing year and grain harvest is likely to exceed 60 m tonnes again in 2014.

Privatisation. On the 17th of July the Government approved the list of stakes in 164 companies to be sold in 2014.

External sector: Current account deficit in June reached USD 0.4 bn despite low merchandise trade deficit due to income outflows and low services export.

Fiscal policy: Gross fiscal revenues (before VAT refunds) in July were lower than planned by 6.6% or UAH 16.2 bn.

Social policy: The Parliament approved more direct control of the Government and the Ministry of Social Policy over social security funds.

Labour market: Economic recession continues to put a downward pressure on average wage growth: average wage in Ukraine (not including Crimea) increased by 6.0% yoy in nominal terms but decreased by 5.6% yoy in real terms in June 2014.

Monetary policy: CPI growth in July slowed to the lowest level over the last six months (0.4% mom) in response to seasonal factors, good harvest of vegetables, low consumer demand and several months of stable exchange rate.

Exchange rate: In July hryvnia exchange rate was stable for the most of the month. Political instability led to slight weakening of the hryvnia vs US dollar by the end of July.

State debt: The Ministry of Finance issued the first tranche of VAT bonds at UAH 5.7 bn to cover previous VAT refund arrears.

Highlight of the month: Budget amendments

BUDGET LAW AND TAX CODE AMENDMENTS: WILL THEY IMPROVE THE SITUATION?

Oleksandra Betliy

In July budget revenue shortfalls were increasing due to economic slowdown, while security and defence programs required more financing. The Government also needed to reach agreement with the IMF mission on continued funding under the Stand-by arrangement. IMF mission agreed to revise performance indicators of the Program due to worse than previously expected economic downturn. The Government still needed to implement a package of revenues and expenditures measures to compensate for high security spending and reduce structural deficit. However, consultations between Parliament factions and the Government on the approaches to revise the budget almost led the Prime Minister Arseniy Yatsenyuk to submit his resignation. In the end, the compromise was found and fiscal parameters were revised to satisfy the requirements of the IMF and finance the military operations in the Eastern Ukraine. The government resignation was not accepted.

The initial draft laws of the Government (on amendment to the Budget Law and the Tax Code) envisaged unpopular measures including restrictions on wage payments and unpaid administrative leave of public employees as well as no indexation of pensions for inflation, and some other. After compromise version was found unpopular decisions were still made. However, the Government had to tone down draft laws and make concessions to gather necessary votes. Final versions of draft laws were approved on July 31 and became effective on August 3.

On the revenues side, the Parliament approved "war fee", which is an additional tax on wage income with the rate of 1.5%. Revenues from the war fee will go to the general fund of the central budget as opposed to the regular PIT that goes to local governments. Overall, the Government expects UAH 2.9 bn to be collected from this fee over the next 5 months. This fee is supposed to be effective only by the end of 2014. The Parliament also approved changes in taxation of deposit interest in early July requiring banks to deduct 15% tax from interest payments at the source. According to previous plans PIT on interest income was to be collected annually with tax declarations. UAH 3.3 bn will be received this year instead of the next year. Higher revenues will be also ensured by increased rent and excise payments although some of the increases were temporary and will last until December 31. The Verkhovna Rada also eliminated several tax breaks and extended current VAT refund rules for agricultural exporters until December 31 from October 1. At the same time, the Government revised downwards targets of EPT and VAT revenues to take into account economic slowdown (according to revised official forecast real GDP will decline by 6% in 2014), including bad financial results of companies and lower imports and consumption.

The Government also introduced large changes in VAT administration that will become effective since January 1. Changes will require companies to pay VAT in advance and are supposed to drastically reduce VAT fraud. At the same time, companies will no longer enjoy what was essentially interest-free short-term loans from public purse and may have to face higher effective tax rates. The Government promised to submit 2015 budget based and reformed Tax and revised Budget Code. It presented a Concept of tax reform which envisages reduction in number of taxes and changes of some tax rates since 2015. This is supposed to put 2015 budget on more sound footing.

On expenditure side, the Government increased security and defence financing with a partial compensation of such increase by decline in non-security expenditures. In particular, funding for a number of central executive bodies was cut. Besides, 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. Heads of central executive bodies now have a right to shift employees to shorter working schedule or unpaid administrative leave without prior notice usually required by law. Moreover, unpaid administrative leave may exceed 2 weeks period, which is prohibited for private sector. The number of civil servants is also to be reduced by 30-50%, although it is not clear what is the timeline for announced layoffs. The Government also cut support of some sectors. In particular, the state aid provided to coal mines is to be reduced by UAH 1 bn, which is justified by higher prices for coal and expected increase in cost efficiency of such companies.

The Parliament also granted the Government additional discretion to control expenditures. The Government received the authority to make changes in legislatively required indexation of pensions to inflation as well as change levels of social assistance. It also received a right to reallocate single social contribution collections between social funds and reduced autonomy of social funds. According to the revised Budget law the central fiscal transfer to the Pension Fund was reduced by UAH 2.1 bn, but it will receive additional UAH 2.0 bn from single social contribution, which were due to other state social insurance funds.

The expected increase in central fiscal revenues was exactly mirrored with respective increase in spending, which resulted in unchanged target of central fiscal deficit. The deficit is to be primarily financed at the expense of external borrowings. The plan of privatisation receipts remained at UAH 17 bn, which is unlikely to be executed by the end of year due to high political and economic uncertainty.

Besides, the Government increased the marginal level of state debt from UAH 664 bn to UAH 807 bn. Therefore, state debt will exceed 60% of GDP, which was defined as a cap for the debt. The Government increased planned support of the Naftogaz by UAH 63 bn to UAH 102 bn in state domestic bonds, which is excluded from official deficit. Other reason for the revision is changed projection of end-year exchange rate.



Therefore, the fiscal vulnerability of Ukraine has increased even further, bringing the issue of debt sustainability high into agenda.

Overall, the Government likely did best it could under complicated circumstances to ensure continued military spending and cooperation with IMF. However, fiscal challenges remained as fiscal gap is large and requires good collection rates of taxes as well as effective privatisation of blue chips in time of political and economic instability.



Monthly Economic Monitor Ukraine

Politics: Early parliamentary election is expected in October

The parliament. On July 24, the governing coalition in Ukrainian parliament (the Verkhovna Rada) collapsed. It happened after the Udar and Svoboda parties quit the coalition in order to open the possibility of an early parliamentary election. This decision was endorsed by the President Petro Poroshenko, who stated that society requested a complete renewal of power. According to the Constitution, President may dissolve the parliament if a new coalition is not formed within 30 days after the collapse of an old one. The collapse of the coalition nearly provoked a government crisis. On July 24, Prime Minister Arseniy Yatseniuk submitted his resignation after Rada failed to pass budget legislation submitted by the Government. However, the resignation was not accepted by the parliament. It is expected that no coalition will be created in August and Ukraine will hold an early parliamentary election in October. However existing Parliament will likely continue to pass laws introduced by the Government despite formal absence of the coalition

War in the East. In July, Ukrainian government intensified fighting against pro-Russian separatists, which tried to separate Donetsk and Luhansk regions from Ukraine. The government forces cleared a number of towns and villages of separatists, including the towns of Sloviansk, Severodonetsk and Lysychansk. That was achieved at a cost: the number of Ukrainian soldiers and officers that were killed in action in July is comparable to the number of servicemen killed in the previous two and a half months (the total number was 363 as of July, 30, according to the National Security and Defense Council of Ukraine). According to the Office of UN High Commissioner for Human Rights estimates, at least 1,129 people were killed in the conflict as of July, 26. The separatists continued to control some cities and towns in the region, including the cities of Donetsk and Luhansk.

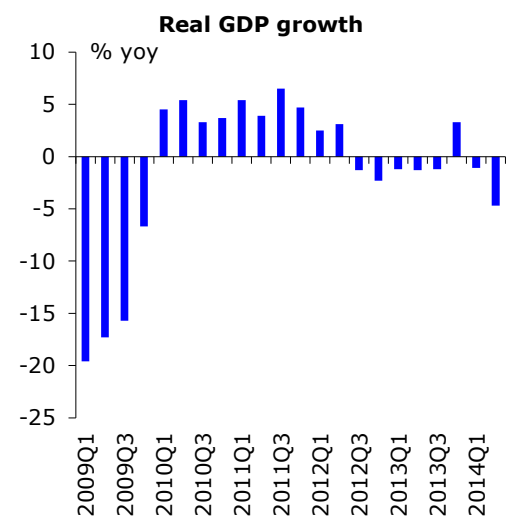
In July, it became more evident that the conflict was not an internally driven uprising, but a covert aggression of Russia, which sent mercenaries and volunteers to Ukraine, supplied them with weapons (including tanks and medium-range surface-to-air missile systems), and shelled Ukrainian troops from its territory. Western countries started to impose sectoral sanctions on Russia after a Malaysia Airlines passenger plane was shot down by separatists in Donetsk region on July 17, killing all 298 people on board. But so far those sanctions did not have any appreciable influence on Russia. In July, the negative impact of the war on the economy of Ukraine increased as critical infrastructure including a number of railroad overpasses, power transmission lines, water and sewage systems in Donetsk and Luhansk regions were destroyed or damaged during the conflict. The war may last at least several months.

The IMF. On June 24-July 17, an IMF mission visited Kyiv for the first review of Stand-By Arrangement (SBA) with Ukraine. The mission concluded that Ukraine's authorities generally implemented the economic program that was supported by the SBA. However, the mission also stated that economic prospects of Ukraine deteriorated due to the ongoing military conflict in the East, which put strain on the government's ability to carry out the program. In response IMF agreed to relax performance criteria of the program and the government committed to take a number of compensatory measures. On July 31, the parliament of Ukraine passed a bill approving those revenue and expenditure measures. It is expected that the IMF Executive Board will approve the review of Ukraine's economic program in late August after summer recess, which will allow Ukraine to obtain the second disbursement under the SBA in the amount of SDR 914.67 m (about USD 1.4 bn).

Real sector: GDP fell by 4.7% yoy in the second quarter

GDP. Real GDP declined by 4.7% yoy in the second quarter of 2014 according to preliminary Ukrstat estimate. This likely reflects falling investment and slowdown in consumption.

Population: 45.5 m
Industry/GDP: 23%
Agriculture/GDP: 10%
Investment/GDP: 18%
Exports to: Russia 24%, EU 26%
Imports from: Russia 30%, EU 35%



Source: Ukrstat

Sectoral trends. Decline in industrial output in June was at 5% yoy reflecting anti-terrorist operation, trade war with Russia and low domestic demand. Output in extraction industry decreased by 4.8% yoy, as lower demand for coal and unrest in Donetsk and Lugansk regions led to 10% yoy drop in coal extraction. Manufacturing production dropped by 5.9% yoy due to weak domestic and external demand. Metallurgy production remained broadly stable over the last months as decrease in production in war-affected regions was offset by ample spare capacities in more stable parts of Ukraine. Machine building production suffered the most from trade disruptions with Russia and declined by 21.8% yoy. Besides a number of machine-building plants located in Donetsk and Lugansk regions stopped their work (e.g., "Novokramatorsky machine-building plant", "Energomashspetsstal Plant", "Kramatorsky heavy-machine tools Plant"). Output of locomotives and railway carriages declined by 59.8% yoy due to low demand from Russia and stoppages in production. Output in chemical production declined by 21.7% yoy as key chemical plants ("Stirol" in Gorlovka and "Azot" in Severodonetsk) stopped their work and external demand for nitrogen fertilizers remained weak.

Drop in construction works accelerated to 25.7% yoy in June). This is explained by sharp drop in construction in Donetsk and Lugansk regions on the background low demand for residential construction and minimal investment spending in the whole of Ukraine.

Agricultural production in June declined by 17.6% yoy due to later start of harvesting this year.

Between January and June retail trade turnover growth decelerated to 0,8% yoy, and retail sales of enterprises in June dropped by 9.3% yoy. This reflects double-digit inflation and slowdown in nominal household spending growth.

Energy: Ukraine saves gas for the heating season

To compensate for the absence of the Russian gas imports Ukrainian government takes steps to replace gas imports and decrease gas consumption.

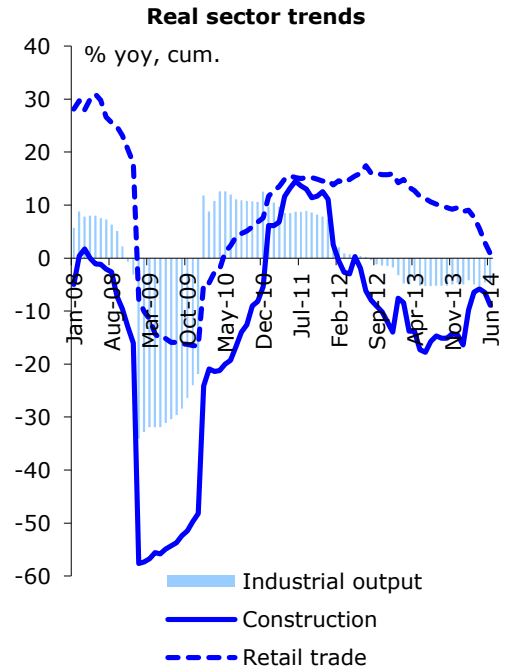
Slovak gas transport company Eustream announced that it expects to finish construction works at Vojany pipeline by September 1. Eustream plans to start pre-commissioning testing towards the end of August. The Slovak company may transport up to 10 bcm of gas per year to Ukraine till 2019. German gas company RWE has already expressed its willingness to use that route for gas supplies to Ukraine. Naftogaz also announced a tender on gas supplies to Ukraine via Hungarian route (through Beregdaróc). In June, Ukraine received 329 m cubic meters of gas from Poland and Hungary.

As part of gas economy measures the Cabinet of Ministers ordered industry and utility companies to reduce gas consumption by 30% and the budget entities are expected to save 10%. Overall, during August 2014 - March 2015 Ukraine is expected to consume 30.23 bcm of gas: the gas consumption limit for industry is set at 7.53 bcm, budget enterprises - 0.63 bcm, utility companies - 5.85 bcm, households - 13.56 bcm and technical losses - 2.66 bcm. Taking into account gas extraction and gas in storage Ukraine needs to import additional 7.23 bcm of gas for the coming heating season.

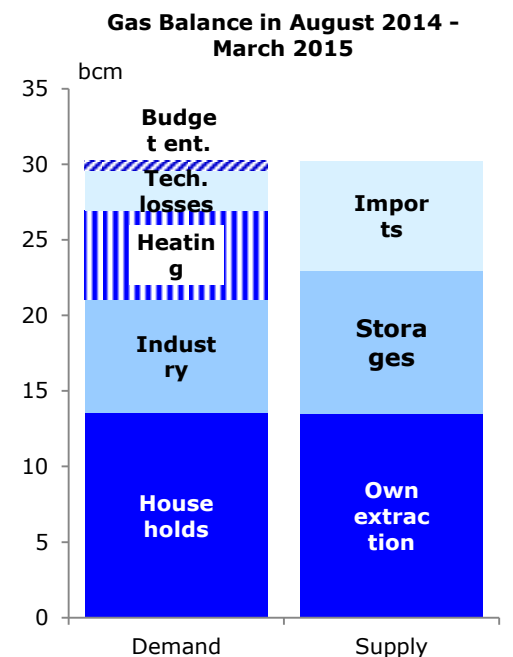
Ukrainian Government continues to take steps to decrease the deficit of Naftogaz that may reach UAH 80 bn in 2014. The Cabinet of Ministers implemented mechanism that transfers part of customer payments for hot water and heating directly to Naftogaz including 100% of customer payments for companies with two months' worth of arrears. The exact distribution will be set by the National Commission of the State Public Utilities Regulation.

Agricultural sector: Ukraine strengthened its positions at the international grain market

According to USDA Ukraine exported a record 32.2 m tonnes of grains in the 2013/2014 marketing year. Ukraine became third largest grain



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



Source: Ministry of Energy

exporter after the USA (72.3 m tonnes) and the EU (38.5 m tonnes). Ukraine more than doubled its grain exports since 2005.

Good harvest is also expected in 2014. Favourable weather conditions in winter and during sowing campaign in spring increased productivity of winter and spring grains. According to the Hydrometeorological centre of Ukraine, gross harvest could reach about 63 m tonnes (including for 1.2 m tonnes in occupied Crimea), which is close to grain production in 2013. In particular, agrometeorologists estimate winter crops harvest at 26.7 m tonnes, spring barley at 5.3 m tonnes, spring wheat at 0.4 m tonnes, corn at 29.3 m tonnes and other crops at 1.3 m tonnes. However, USDA estimates are more pessimistic. In particular, grain harvest in Ukraine is projected at 57.1 m tonnes and exports at 27.4 m t in the 2014/15 marketing year.

According to the Ministry of Agricultural Policy and Food, 23.6 m tonnes of grains and legumes were already harvested in the area of 7.1 m ha by the end of July. Harvesting of winter crops is fully completed in Kherson and Zaporizhya regions and almost finished in Mykolaiv and Dnipropetrovsk regions.

Privatisation: New unlikely target for privatization

On 17th July the Government approved the list of stakes in 164 companies that will be sold in 2014. List includes companies from energy, engineering and chemical industries, including fertilizer producer Odessa Port Plant and the largest machine building enterprise Azovmash.

According to the government estimates, the market price of all the stakes is equal to UAH 15 bn, which is close to this year's privatization target. However, unrest in the Eastern Ukraine and economic downturn will limit number of investors and the Government will likely be forced to choose between selling cheaply or cancelling auctions and getting even less funds from privatisation.

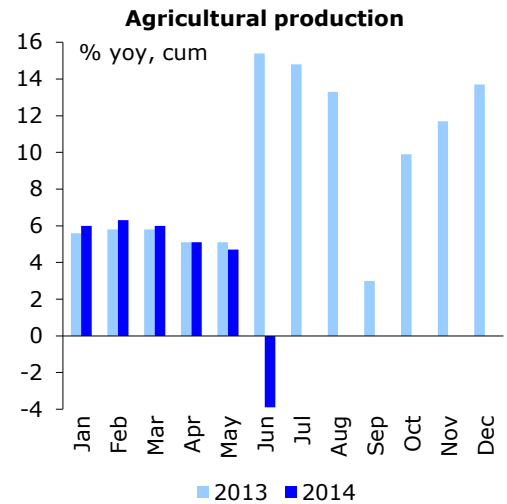
External sector: Summer started with FDI and foreign currency inflows

Current account deficit in June was USD 0.4 bn. Merchandise trade balance was negative with imports exceeding exports by USD 0.3 bn. Export of services dropped by 35% yoy while net payments of investment income increased to USD 0.8 bn.

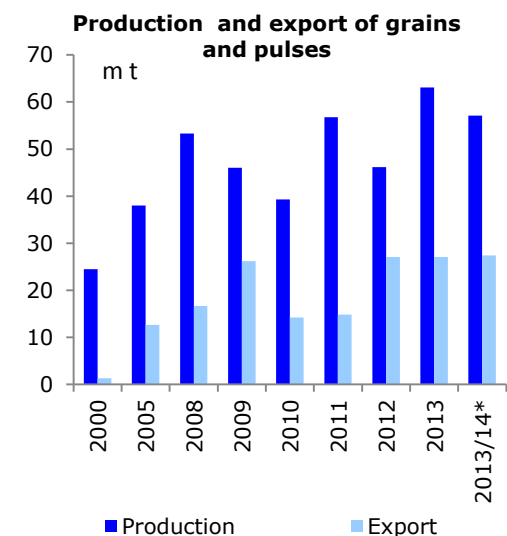
Exports of goods declined by 7.9% yoy reflecting low external demand, disruptions in production and trade war with Russia. The major drop occurred in exports of machinery (-24% yoy) and chemicals (-18% yoy) as some exporters located in Donetsk and Lugansk oblasts are not currently operating due to armed conflict in the region. Lower exports of food products (-4.5% yoy) is explained by lower prices for grain. In response to lower dollar costs and improved demand exports of metals increased by 5% yoy.

Merchandise imports contracted by 17.5% yoy in June. As a result of depressed demand and import substitution imports returned to 2009-2010 levels in dollar terms. Non-energy imports dropped by 28% yoy while demand for investment goods dropped even further. Imports of metalurgy products fell by 40% yoy while imports of machinery, equipment and transport products fell by 39% yoy.

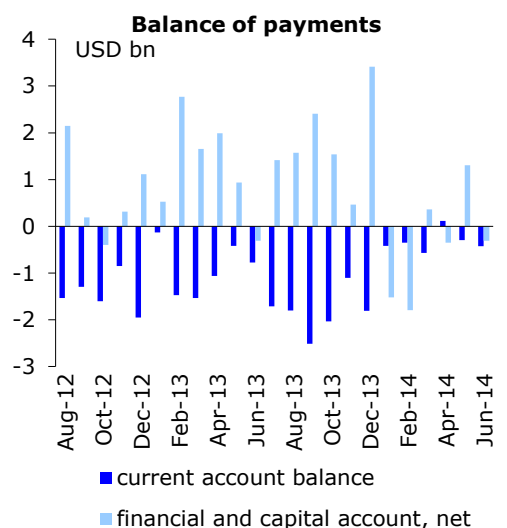
Financial and capital account balance in June was negative at USD 0.3 bn. On the one hand government received USD 1 bn in macrofinancial assistance from EU recorded as USD 0.3 bn under capital account and USD 0.7 bn as a loan. Net FDI inflow reached USD 0.2 bn. Cash foreign currency outside banks decreased by USD 0.2 bn due to seasonal factors and lower volatility of exchange rate. Continued acquisition of Russian gas by the Naftogaz without payment was also recorded as inflow under financial account. On the other hand private sector was able to raise only USD 0.3 bn in medium and long-term external financing which was insufficient to cover scheduled repayments. Non-residents also decreased deposits in Ukrainian banks.



Source: Ukrstat



Source: Derzhstat, UN comtrade (export in 2013)
 *USDA estimate of grain production and exports in Ukraine for 2013/14 marketing year.



Source: NBU preliminary estimates

External sector: Summer started with FDI and foreign currency inflows

Current account deficit in June was USD 0.4 bn. Merchandise trade balance was negative with imports exceeding exports by USD 0.3 bn. Export of services dropped by 35% yoy while net payments of investment income increased to USD 0.8 bn.

Exports of goods declined by 7.9% yoy reflecting low external demand, disruptions in production and trade war with Russia. The major drop occurred in exports of machinery (-24% yoy) and chemicals (-18% yoy) as some exporters located in Donetsk and Lugansk oblasts are not currently operating due to armed conflict in the region. Lower exports of food products (-4.5% yoy) is explained by lower prices for wheat, which was realised in previous periods. In response to lower dollar costs and improved demand exports of metals increased by 5% yoy.

Merchandise imports contracted by 17.5% yoy in June. As a result of depressed demand and import substitution imports returned to 2009-2010 levels in dollar terms. Non-energy imports dropped by 28% yoy while demand for investment goods dropped even further. Imports of metallurgy products fell by 40% yoy while imports of machinery, equipment and transport products fell by -39% yoy).

Financial and capital account balance in June was negative at USD 0.3 bn. On the one hand government received USD 1 bn in macrofinancial assistance from EU recorded as USD 0.3 bn under capital account and USD 0.7 bn as a loan. Net FDI inflow reached USD 0.2 bn. Cash foreign currency outside banks decreased by USD 0.2 bn due to seasonal factors and lower volatility of exchange rate. Continued acquisition of Russian gas by the Naftogaz without payment was also recorded as inflow under financial account. On the other hand private sector was able to raise only USD 0.3 bn in medium and long-term external financing which was insufficient to cover scheduled repayments. Non-residents also decreased deposits in Ukrainian banks.

Fiscal policy: State Budget was amended

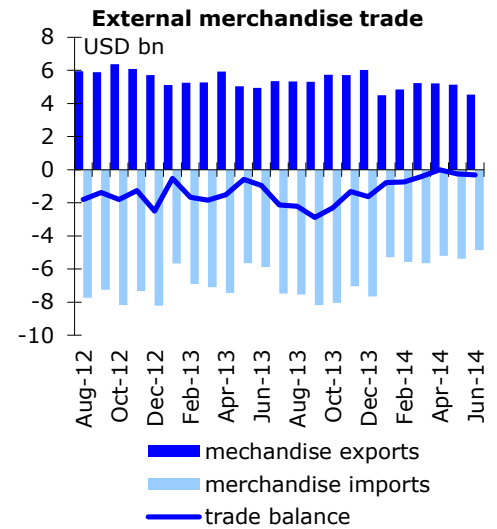
Preliminary data. According to the preliminary data of the State Treasury, central fiscal revenues in July increased by near 5% yoy partially due to decline in VAT refunds. Gross revenues (before VAT refunds) were lower than planned by 6.6% or UAH 16.2 bn.

Overall, growth of revenues decelerated to 7.7% yoy in the first seven months of the year. They were supported by increased transfer of the NBU profit to the budget and lower VAT refunds. At the same time, the Government provided companies with the first issue of the VAT-bonds at UAH 5.7 bn.

6 months. In the first half of 2014 growth of central fiscal revenues slowed down to 8.1% yoy as the transfer of the NBU profit to the budget was executed during first five months of the year. This transfer reached UAH 22 bn in the first six months of the year as compared to UAH 10 bn in the same period of last year. Tax revenues remained at the level of previous year as VAT refunds dropped by 26% yoy. EPT collections dropped by 18.2% yoy due to bad financial results of companies. At the same time, excise revenues grew by 6% yoy due to higher collections of excise on imports, which was ensured by hryvnia depreciation.

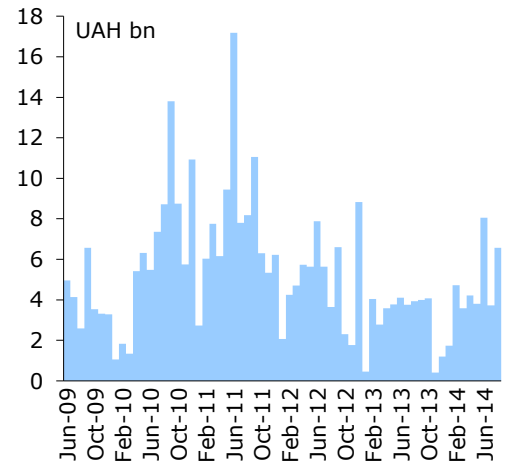
Central fiscal deficit surged to UAH 22.7 bn in the first six months of the year as compared to UAH 12.2 bn in the first five months. The Government used some of the funds raised from external borrowing as funds on government accounts at the NBU dropped by UAH 12 bn. At the same time, central fiscal expenditures (general fund) were lower than target by 8.6%.

Budget amendments. In July the Parliament approved amendments to the State Budget Law to account for lower than planned revenues as well as well compensate for increase in expenditures for security. To compensate for lost revenues the Government increased rent payments, excise tax rates, cancelled some tax exemptions and



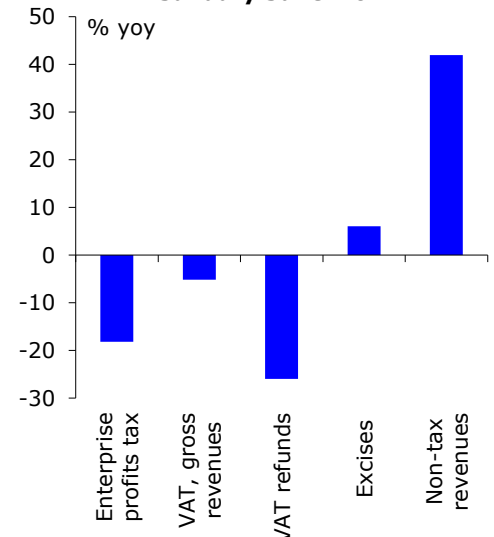
Source: NBU preliminary estimates

Balance of the Single Treasury Account



* in the beginning of month
Source: State Treasury

Growth of central fiscal revenues January-June 2014



Source: State Treasury reports

introduced temporary 1.5% war tax on private income. Budget amendments also sought to cut non-security spending. As a result, revenues target was increased by UAH 4.9 bn to UAH 373 bn. Plan of central fiscal deficit remained unchanged.

State aid. The Parliament attempted to streamline state aid to economy and comply it with Ukraine's obligations under the EU-Ukraine Association agreement. The Law sets procedures for state aid in order to avoid damage to competition and inefficient state spending. Existing system is incoherent and state aid is sometimes granted to favoured companies in an arbitrary manner. The Antimonopoly Committee will be responsible for compliance with EU-imposed rules on provision of the state aid and will screen all regulations and draft laws that are intended to provide some benefits to companies or sectors of economy for their effect on competition. However, the Antimonopoly Committee in Ukraine so far exhibited limited independence and weak institutional capacity. Transition to new rules will be gradual and hopefully it will be able to effectively regulate state aid in three years when the Law is to be fully implemented.

Social policy: Manual control over social security funds

The Parliament approved more direct control of the Government and the Ministry of Social Policy over social security funds. It allowed the Government to distribute funds from single social contribution to social security funds as it deems necessary instead of legislatively provided distribution.

In particular, central fiscal transfer to the Pension Fund was reduced by UAH 2.1 bn to UAH 81.7 bn. But the Pension Fund will instead receive UAH 2.0 bn that were due to the Unemployment fund and the Social insurance fund in case of temporary working disability. Such reallocation means that the Unemployment fund will have less money for active and passive labour market policies at the time of increasing unemployment.

Labour market: Real wage tumbles

Economic recession continues to put a downward pressure on average wage growth: average wage in Ukraine (not including Crimea) increased by 6.0% yoy in nominal terms but decreased by 5.6% yoy in real terms in June 2014. Increase in nominal wage was accompanied by 3.5% yoy decrease in number of salaried employees.

Average wage in industry grew by 7.2% yoy in part due to 6.2% yoy increase in minimum wage and limitations on decreases in nominal wages. Still some industries were able to increase wages in real terms. These include export-oriented sectors (metallurgy and textile industry) that didn't suffer from trade disruptions with Russia as well as pharmaceutical industry which was able to increase prices by 20% yoy and enjoys inflexible demand.

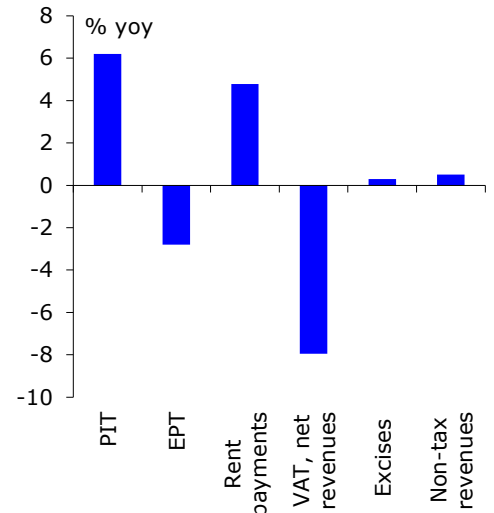
Wage growth in agricultural sector remained below average at 4.8% yoy. High fiscal pressure resulted in low wage growth in publicly funded sectors (in education at 3.5% yoy, in health care at 2.8% yoy, in public administration and defence at 4.4% yoy).

Monetary policy: CPI growth slowed to 0.4% mom in July

In July CPI increased by 0.4% mom. CPI growth slowed to lowest level over the last six months in response to seasonal factors, good harvest of vegetables, low consumer demand and several months of stable exchange rate. Price index for vegetables dropped by 30.7% mom subtracting 1.2% from CPI. This was offset by sharp increase in tariffs for cold and hot water that added 0.5% to CPI. Month-to-month core inflation (that excludes raw food products and administratively set prices) slowed down for three months in a row to 0.8% mom. Still delayed effects of hryvnia depreciation and high inflation expectations supported continued price increases for some products and consumer inflation reached 12.6% yoy in July.

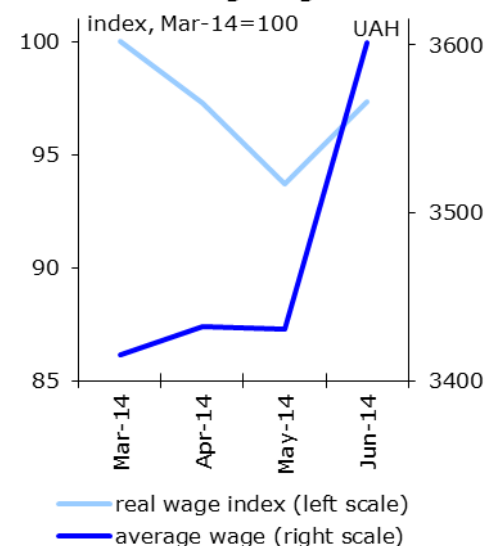
The NBU in July increased discount rate to 12.5% p.a. from 9% p.a. but with little effect for regular monetary operations (emergency

Amendments to the State Budget Law for 2014



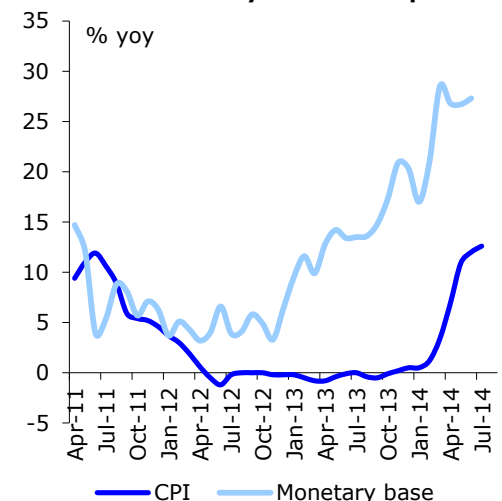
Source: The Law on Amendments to the State Budget Law from July 30, 2014

Average wage*



*not including AR Crimea
Source: Ukrstat

CPI and monetary base development



Source: Ukrstat, NBU

refinancing became more expensive). Regular refinancing was not used by most banks and interest rate on more widely used overnight deposit facility changed only to 5% p.a from 4.5%. Healthy banks in July retained sufficient liquidity and interbank interest rates remained in 5-10% p.a range.

Exchange rate: Stable exchange rate for the most of July

In July some restrictions were removed from foreign currency operations including mandatory sale of foreign currency transfers to individuals and restrictions on outgoing foreign currency transfers of individuals. Still, most administrative measures on foreign currency market remained intact. UAH/USD exchange rate remained stable in UAH 11.6-11.8 per USD range for the most of July, but hryvnia weakened closer to UAH 12 per USD after the Prime Minister in effect threatened to resign if several government draft laws are not approved.

International reserves again decreased in July to USD 16.1 bn despite USD 80 m in purchases of foreign currency by the NBU. This reflected net repayments of foreign currency debt by the Government.

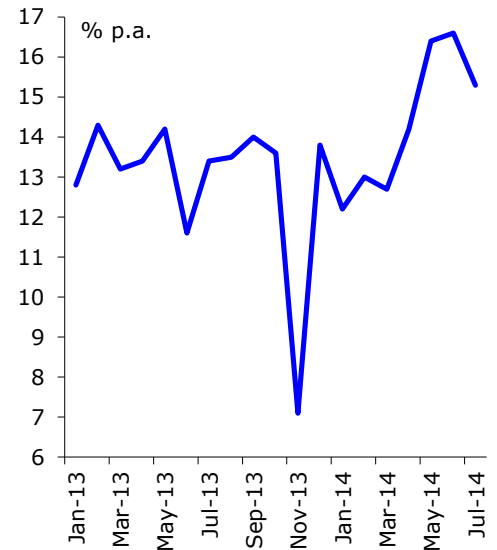
State debt: Two first tranches of VAT bonds were issued

Domestic debt. In July the Ministry of Finance placed UAH 5.5 bn of hryvnia denominated bonds as compared to UAH 4.6 bn in June. Weighted average yield dropped by 1.3 p.p. to 15.3% p.a. One- and two-year bonds accounted for 71.7% of the total placement. At the same time, the Government sold USD 200 m of one-year USD-denominated bonds with 8% coupon on the same day as similar USD bond matured. This was likely non-market transaction.

The Ministry of Finance issued the first tranche of VAT bonds at UAH 5.7 bn (out of UAH 7.0 bn planned by the Cabinet of Ministers) to cover previous VAT refund arrears. The bonds were issued with 5-year maturity, semi-annual amortization and coupon payments at 9.50% p.a.

External debt. In July World Bank approved Social Safety Nets Modernization Project that foresees up to USD 300 m in loans from the World Bank between 2015 and 2021. It was granted for 18 years with 5 year grace period. The project is aimed at improving the performance of Ukraine's social assistance and social services system for low-income families. It is the part of the USD 3.5 bn financial assistance package to Ukraine envisaged by the World Bank for 2014.

Weighted average yield for domestic state bonds



Source: NBU

Economic Trends		Q3 12	Q4 12	Q1 13	Q2 13	Q3 13	Q4 13	Q1 14	Q2 14	Oct	Nov	Dec	Jan	Feb	Mar	Apr^c	May^c	Jun^c	Jul^c
Industrial production (real)	% yoy cum.	-1.2	-1.8	-5.0	-5.3	-5.2	-4.7	-5.0	-4.7	-5.2	-5.0	-4.7	-5.0	-4.2	-5.0	-5.3	-4.6	-4.7	...
Construction (real)	% yoy cum.	-9.1	-14	-13.8	-17.8	-15.1	-14.5	-6.4	-8.9	-15.1	-14.3	-14.5	-16.4	-9.8	-6.4	-5.8	-6.5	-8.9	...
Agricultural production (real)	% yoy cum.	-4.6	-4.5	5.8	15.4	3.0	13.7	6.0	-3.9	9.9	11.7	13.7	6.0	6.3	6.0	5.0	4.7	-3.9	...
Retail trade turnover (real)	% yoy cum.	16.0	15.9	13.4	11.2	9.8	9.5	7.7	0.8	9.5	9.2	9.5	8.8	9.0	7.7	5.6	2.9	0.8	...
Average wage	UAH	3064	3195	3085	3289	3331	3390	3245	3488	3283	3268	3619	3148	3189	3398	3432	3430	3601	...
CPI	% yoy eop	0.0	-0.2	-0.8	-0.1	-0.5	0.5	3.4	12.0	-0.1	0.2	0.5	0.5	1.2	3.4	6.9	10.9	12.0	12.6
PPI	% yoy eop	0.3	0.3	0.2	-1.6	-0.9	1.7	3.9	15.9	0.8	-0.5	1.7	1.9	3.3	3.9	6.1	8.8	15.9	22.5
Exports (USD)*	% yoy cum.	2.6	1.0	-4.7	-7.1	-6.2	-5.2	-7.7	...	-9.0	-8.8	-7.6	-12.2	-10.0	-6.8	-8.3	-6.4	-6.7	...
Imports (USD)*	% yoy cum.	7.6	5.6	-0.8	-8.3	-4.1	-3.4	-14.7	...	-6.0	-5.7	-5.8	-6.7	-13.6	-16.1	-19.9	-17.3	-17.3	...
Merchandise trade balance	USD bn cum.	-14.8	-20.5	-4.0	-7.1	-14.2	-19.6	-1.9	...	-16.6	-18.0	-19.6	-0.8	-1.5	-1.9	-2.0	-2.2	-2.5	...
Current account**	USD bn cum.	-10.0	-14.4	-3.1	-5.5	-11.4	-16.4	-1.3	...	-13.4	-14.5	-16.1	-0.4	-0.8	-1.3	-1.2	-1.5	-1.9	...
Gross international reserves	USD bn eop	29.3	24.5	24.7	23.2	21.6	20.4	14.2	...	20.6	18.8	20.4	17.8	15.5	15.1	14.2	17.9	17.1	16.1
Monetary Base	% yoy eop	5.8	6.4	9.9	13.4	14.8	20.3	28.5	...	17.3	20.9	20.3	17.0	21.0	28.5	26.8	26.7	27.3	...
Lending rate on UAH credits	% pa, aop	19.6	20.8	16.2	15.4	15.3	16.5	18.5	17.5	15.4	16.7	17.4	15.1	20.3	20.0	17.5	17.9	17.2	...
Exchange rate (interbank)	USD aop	8.10	8.15	8.12	8.14	8.15	8.21	9.1	11.71	8.18	8.20	8.24	8.37	9.08	9.98	11.61	11.78	11.79	11.74
Exchange rate (official)	USD aop	7.99	7.99	7.99	7.99	7.99	7.99	8.85	11.71	7.99	7.99	7.99	7.99	8.65	9.92	11.64	11.64	11.81	11.76
Exchange rate (official)	EUR aop	9.99	10.37	10.55	10.44	10.58	10.87	12.14	12.14	10.90	10.79	10.94	10.92	11.80	13.69	16.08	16.00	16.04	16.04

Sources: Ukrstat, NBU, ICAP, own calculations

* Monthly figures are only for merchandise exports and imports (source: NBU, preliminary data)

Quarterly figures are for trade in goods and services (source: NBU)

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

^c Data excludes Crimea

Key Economic Indicators		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
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
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
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
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
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
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
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
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
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
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
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
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
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
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
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
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
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	40.1
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
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
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
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
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
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

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

^{'''} "Minus" denotes a consolidated fiscal deficit; without recapitalisation

Notes:

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



Quarterly trends

National accounts		Q3 09	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	
GDP	UAH bn	250.3	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	313.0	
GDP (real)	% yoy	-15.7	-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	-1.1	
Household consumption (real)	% yoy	-14.3	-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	5.7	
State consumption (real)	% yoy	-4.3	-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	-9.1	
Gross fixed capital formation (real)	% yoy	-53.2	-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	-19.1	
Exports of goods and services (real)	% yoy	-30.9	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	-2.0	
Imports of goods and services (real)	% yoy	-47.6	-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	-7.0	
Agriculture, hunting, forestry (real)*	% yoy	2.2	-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	6.0	
Manufacturing industry (real)*	% yoy	-25.6	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	-6.8	
Construction (real)*	% yoy	-43.6	-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	-3.9	
Trade, repair services (real)*	% yoy	-22.0	-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	3.1	
Transport (real)*	% yoy	-5.7	-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	-5.8	
Balance of payments																			
Current account balance	USD bn	-0.1	-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	-0.6	
Current account balance	% of GDP	-0.2	-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	-1.8	
Trade balance in goods	USD m	-1396	-1407	-1236	-697	-3597	-2851	-4580	-5224	-3867	-5577	-5215	-5833	-4045	-3053	-7232	-5268	-1486	
Trade balance in services	USD m	1256	550	930	1115	1262	1514	2007	1312	1299	1362	1975	1084	822	893	1919	480	820	
Current transfers	USD m	640	722	608	728	1039	878	988	803	683	805	777	711	533	589	480	547	232	
Direct investment (FDI)	USD m	1210	1282	923	1196	880	2422	2090	1623	1663	1091	2002	1871	821	472	1199	859	-543	
Portfolio investments (equity)	USD m	32	41	-20	-18	149	113	42	207	-3	74	83	339	705	579	664	-757	-252	
Gross international reserves	USD bn	28.2	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	14.2	
Exchange rate (interbank), UAH/USD	aop	7.99	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	
Exchange rate (official), UAH/USD	aop	7.82	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	
Fiscal indicators																			
Consolidated fiscal revenues	% of GDP	25.5	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	
Personal income tax	% of GDP	4.4	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	
Enterprise profits tax	% of GDP	3.7	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	
Value-added tax	% of GDP	6.4	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	
Excise tax	% of GDP	2.5	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	
Consolidated fiscal expenditures	% of GDP	29.6	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	35.7	
Current expenditures	% of GDP	27.0	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	35.2	
Capital expenditures	% of GDP	2.6	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	
Consolidated fiscal balance	% of GDP	-4.5	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	
Privatisation receipts	% of GDP	0.1	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	
Labour market																			
Average wage (real)	% yoy	-10.7	-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	
Household income (real)	% yoy	-8.6	-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	...	
Unemployment rate (ILO methodology)	% cum	7.8	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	...	
Banking system																			
Monetary aggregate M0	% yoy cum	11.5	1.5	5.4	9.9	15.7	11.5	8.6	6.3	4.7	6.7	5.2	5.5	9.7	9.8	12.3	17.0	19.2	
Monetary aggregate M2	% yoy cum	-1.4	-5.4	6.9	13.2	25.5	22.0	16.0	14.4	11.2	9.0	10.7	13.1	16.0	17.9	19.2	17.5	17.7	
Household deposits in national currency	% yoy cum	-25.4	-8.5	7.1	20.1	43.3	26.0	16.7	12.3	14.4	16.4	16.3	16.3	19.1	26.5	33.4	38.0	7.9	
Household deposits in foreign currency	% yoy cum	39.2	4.7	22.8	21.5	19.7	21.0	15.7	13.4	12.4	10.8	17.0	21.8	17.0	14.7	8.4	0.9	19.8	
Com. bank credits in national currency	% yoy cum	25.2	16.9	13.6	8.3	16.0	18.5	21.1	21.0	17.4	15.3	9.1	7.7	8.6	7.4	10.2	16.9	12.3	
Com. bank credits in foreign currency	% yoy cum	32.4	-15.2	-13.7	-10.5	-2.1	0.9	-2.3	-4.2	-7.0	-10.8	-9.9	-7.3	-4.4	-0.4	0.8	2.8	36.4	
Long-term com. bank credits	% yoy cum	29.9	-3.8	-3.9	-2.8	5.0	6.3	5.3	2.9	-2.9	-7.0	-8.0	-6.6	-5.6	-2.7	-0.5	2.9	26.3	
Long-term com. bank credits	% of total	67.3	68.1	68.5	68.9	67.2	66.6	64.4	62.9	61.5	59.8	59.1	57.8	55.9	55.7	55.1	53.2	58.5	
Average lending rate on national currency credits	% p.a.	17.5	19.8	17.3	15.0	13.1	13.5	14.1	18.4	15.5	15.6	19.5	20.8	16.2	15.3	15.3	16.5	18.4	
Average lending rate on foreign currency credits	% p.a.	10.0	10.1	10.9	11.1	10.2	9.8	8.8	8.4	8.2	8.2	8.5	8.8	9.4	9.7	9.6	8.8	8.7	

Sources: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, Reuters, IER estimates

* change in value added

**Contact information:**

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

Head of the Board-Director

Igor Burakovsky
burakovsky@ier.kiev.ua

Chief Executive

Oksana Kuziakiv
kuziakiv@ier.kiev.ua

Academic Director

Veronika Movchan
movchan@ier.kiev.ua

Centre for Economic Studies

Oleksandra Betliy
betliy@ier.kiev.ua
Vitaliy Kravchuk
Kravchuk@ier.kiev.ua
Iryna Kosse
kosse@ier.kiev.ua
Kateryna Pilkevich
pilkevich@ier.kiev.ua
Artur Kovalchuk
kovalchuk@ier.kiev.ua
Dmytro Naumenko
naumenko@ier.kiev.ua
Svitlana Galko
galko@ier.kiev.ua
Kostiantyn Kravchuk
k.kravchuk@ier.kiev.ua
Victor Grechyn
grechyn@ier.kiev.ua
Mykola Ryzhenkov
ryzhenkov@ier.kiev.ua

Center for Contemporary Society Studies

Iryna Fedets
fedets@ier.kiev.ua
Hanna Opanasenko
opanasenko@ier.keiv.ua

German-Ukrainian Agricultural Policy Dialogue

Yuliya Ogarenko
ogarenko@ier.kiev.ua
Mariya Yaroshko
yaroshko@apd-ukraine.de

Disclaimer

The Monthly Economic Monitor of Ukraine has been prepared by the Institute for Economic Research and Policy Consulting for informational purposes only. All judgments in this report reflect authors' point of view as of date publication, and can be changed without notice. Although we used our best efforts in preparing this publication, we make no guarantees as to its accurateness. The IER does not take any responsibility for any losses or other problems that directly or indirectly resulted from the use of any part of this publication. Reproduction without prior permission is prohibited; when quoting please cite Institute for Economic Research and Policy Consulting.