



# Monthly Economic Monitor Ukraine

No.6 (176), June 2015

## EXECUTIVE SUMMARY

### **HIGHLIGHT: GAS MARKET REFORM**

**Politics:** In May, Ukraine failed to get a visa-free regime for short trips of its nationals to the EU due to slow progress of Ukraine in the implementation of the EU-Ukraine Visa Liberalisation Action Plan.

**Real Sector:** Decline in the industrial output in April at 21.7% yoy was close to drop in March, which might signal that Ukrainian economy reached the bottom.

**Energy sector:** Gas prices for industrial consumers and overall gas consumption are currently on the downward trend.

**Agriculture:** Sown area (not including Crimea) under grain and leguminous crops decreased by 10.5% likely due to higher inputs prices and lower world prices.

**Privatisation:** The Government approved ambitious list of companies to be privatised in 2015.

**External sector:** Current account in April was positive at USD 0.2 bn as merchandise imports contracted at a faster pace than exports.

**Fiscal policy:** Growth of consolidated fiscal revenues in May sharply decelerated to 19.5% yoy from over 40% yoy during the previous two months.

**Social policy:** Number of recipients of housing and utility subsidies more than doubled and reached 7.8% of all families.

**Labour market:** Decline in real average wage accelerated to 29.6% yoy. The sharpest decline was in public sectors.

**Monetary policy:** In May, monthly core inflation slowed down below 2% for the first time since August 2014.

**Exchange rate:** In May, interbank exchange rate continued to fluctuate in the band set by the NBU.

**State debt:** During May the Government continued talks on the restructuring of external state debt with Eurobond holders. So far, agreement was not reached.

# Highlight of the month: Gas market reform

## THE NEW LAW ON GAS MARKET AS AN IMPORTANT BUILDING BLOCK

by Iryna Kosse

On April 9, the Verkhovna Rada adopted the Law of Ukraine "On the natural gas market" which was signed by the President in May and will become effective in October. The Law is an integral part of the big energy market reform and government efforts to decrease dependency from imported energy resources. Gas issues for a long time have been a political hot topic. Ukraine needs to decrease their political importance and start treating gas as any other tradable commodity. The Law introduces free market principles in organisation of the gas market. First of all, it separates the functions of the market operator from those of producers and suppliers and tries to minimize their influence on the operators of the gas transportation system, gas storages, gas distribution systems as well the potential operator of the LNG terminal.

The Law envisages the development of free and fair competition in the natural gas commodity market. To that end the Law also cancels licensing of the wholesale gas traders. The Law also establishes free pricing of the natural gas on the wholesale and retail markets and the free choice of gas suppliers. However, the government has the authority to deviate from this principle in public interest. This means that starting October 1, the National Commission for State Energy and Public Utilities Regulation (NCEPUR) will no longer set the price of gas. The Cabinet of Ministers will use the public service obligations mechanism to regulate certain tariffs to protect the household consumers and potentially other categories of consumers. Since the NCEPUR will no longer set the marginal gas prices, the suppliers will be able to sell gas to industrial consumers at different prices depending on conditions: length of contract, additional services, price setting mechanisms (like linking to spot prices) etc. According to the Naftogaz representatives<sup>1</sup>, during the transition period the Naftogaz will be obliged to sell the gas at discounted price to any gas trader that has contracts with the households, while the final price for the population will be capped by the Cabinet of Ministers.

State regulation of monopoly markets (transportation, distribution, storage, LNG installation services) will be retained. Operators of gas transportation system will still be licensed and procedures for obtaining their services will be regulated. The Law also obliged the regional gas supply companies (oblgases) to pay for using the state-owned gas distribution assets.

According to the Energy Community Secretariat that helped develop the Law "On the natural gas market", the Law fully complies with the international obligations under the "Third Energy Package". In particular, the Law complies with the Directive 2009/73/EC and Regulation 715/2009 in provisions that concern the free choice of suppliers of gas by all consumers, the Transmission System Operators (TSO) model of separating the activities of gas transportation and distribution from gas supply, free access to the infrastructure, monitoring of the security of supplies, adoption of the National Action Plan in the cases of emergency and the protection of vulnerable consumers.

The Law "On the natural gas market" is an important and necessary piece of legislation but it is only a part of the required reforms. It requires the development and adoption of secondary legislation like the Gas Networks Code and the Gas Market Rules. So far, there is no information on progress in devising these legislative acts while the time is limited especially given the need for public discussion of these documents. Second, Ukraine needs fair pricing on the gas market that would create a single wholesale price for gas. At the moment, the wholesale price (as received by the Naftogaz and other gas traders) differs from UAH 1803 per thousand cubic meters (for district heating of household consumers) to UAH 6600 (for industrial consumers excluding VAT). The weighted average price of gas supplied to the population (including district heating) without taxes and transportation costs is UAH 2834 per thousand cubic meters, which is significantly less than the import price. According to the Naftogaz,<sup>2</sup> it will lose UAH 6.1 bn over April 2015-March 2016 by supplying gas to the population at the current prices set below the cost-covering level.

Another key component of gas market reform is energy efficiency. On the gas market, the biggest room for improvement is in more efficient use of gas for heating and hot water. Possible measures include replacement of hot water boilers for more energy efficient units, improved building insulation, and improved metering. For example, under recent legislative changes the budget entities will be also able to use Energy Service Companies<sup>3</sup> for energy saving projects and pay for their services from future appropriations for energy fees.

Overall, the gas market reform is long overdue. Ukraine needs to decrease its dependency on imported gas and move the gas issues out of the political domain. To do that, it has to make the gas market transparent, free and competitive. So far, the Government moves in the right direction.

<sup>1</sup> <http://interfax.com.ua/news/interview/270697.html>

<sup>2</sup> <http://www.naftogaz.com/files/Information/Tariffs.pdf>

<sup>3</sup> An energy service company or energy savings company (ESCO or ESCo) is a commercial or non-profit business providing a broad range of energy solutions including designs and implementation of energy savings projects, retrofitting, energy conservation, energy infrastructure outsourcing, power generation and energy supply, and risk management. The ESCO starts by performing an analysis of the property, designs an energy efficient solution, installs the required elements, and maintains the system to ensure energy savings during the payback period.

# Monthly Economic Monitor Ukraine

## Politics: Government launches a public procurement reform

**Policies.** In May, government agencies continued to gradually enhance transparency and efficiency of public procurement. On May 12, the Ministry of Finance announced that it decided to make small purchases (in the amount of up to UAH 0.1 m for goods and of up to UAH 1 m for services) through ProZorro, an electronic public procurement system developed by civic activists and supervised by the Transparency International. In addition, the Ministry of Defence, which started working with ProZorro earlier, became the first public institution to expand that cooperation to include a more complex procurement procedure (purchase through negotiation). The government considers purchases through ProZorro, which was launched in February 2015, as a pilot project of Ukraine’s public procurement reform. If the cooperation is seen as successful, ProZorro will be brought under government control and expanded to make the most of public purchases. As of May, a number of government agencies and establishments cooperated with ProZorro, including the Ministry of Infrastructure, the Ministry of Health, the Ministry of Justice, and the Ministry of Economic Development and Trade. In 2014, public procurement in Ukraine totalled UAH 250 bn.

**The EU.** In May, Ukraine failed to get a visa-free regime for short trips of its nationals to the EU. It was expected that the EU could grant the regime at the summit of the Eastern Partnership in Riga on May 21-22. However, it did not happen as the progress of Ukraine in implementation of the EU-Ukraine Visa Liberalisation Action Plan (VLAP) was not sufficient. According to the summit declaration, the EU will report on the progress in implementation of the VLAP by the end of 2015. It implies that Ukraine can get the visa-free regime no earlier than in the beginning of 2016. To complete the plan Ukraine has to take steps in several areas: (1) enhancement of document security and protection of personal data, (2) law enforcement reform (including actions aimed at fighting corruption), (3) improvement of protection of asylum seekers, and (4) elimination of discrimination on the labour market.

**Top officials.** On May 30, President Petro Poroshenko granted Ukrainian citizenship to Mikheil Saakashvili, former President of Georgia (in 2004-2013), and appointed him as the Governor of Odesa region. Mr. Saakashvili replaced Ihor Palytsia. Previously Mr. Saakashvili was appointed as the Head of Ukrainian President’s International Advisory Council on Reforms (since February 2015). The appointment of Mr. Saakashvili to Odesa may be considered as a move to decrease the influence of Ihor Kolomoyskii, a billionaire and former Governor of Dnepropetrovsk region, in Odesa region (as Ihor Palytsia was considered as a person close to Mr. Kolomoyskii), and to boost reforms in the region.

On May 16, the Parliament appointed Ihor Bilous as the Head of the State Property Fund of Ukraine (SPF). This position was vacant since June, 2014, in the meantime the Fund was run by Dmytro Parfenenko, the First Deputy Head of the SPF. Mr. Bilous, 37, served as the Head of the State Fiscal Service (SFS) from June 2014 to February 2015. He resigned after the performance of the SFS was deemed unsatisfactory by the government. Previously he held top positions in Kyiv offices of Ukrainian and foreign investment companies, including Altius, Renaissance Capital, and UBS.

On May 19, the Parliament appointed Yurii Terentiev as the Head of the Anti-Monopoly Committee of Ukraine. This position was vacant since March, 2014. In the meantime the Committee was run by Mykola Barash. Previously, Mr. Terentiev, 39, was legal and financial advisor to Ukrainian branches of foreign companies including ArcelorMittal, Metro Cash and Carry, and Bristol-Myers Squibb.

**The war in Donbas.** In May, the low intensity military conflict went on in Donbas. Ukrainian forces continued to respond to a regular harassing fire from pro-Russian insurgents and Russian troops. The

**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%**



Source: Ukrstat

number of casualties continued to increase. According to the United Nations, the conservative estimate of the total death toll from the conflict reached 6,417 on May 30 (it was 6,243 as of May 3). On June 3, insurgents and Russian troops escalated the conflict by attacking Mar'inka, a small town adjacent to Donetsk from the West. The attack was repelled, but both sides brought heavy weapons back to the front line, which increased the probability of further escalation in the nearest weeks.

**Real sector: Economy likely reached bottom**

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

**Sectoral trends.** Decline in the industrial output in April at 21.7% yoy was close to drop in March, which might signal that Ukrainian economy reached the bottom. Contraction is attributed to military conflict in Donbas, low demand and logistic problems.

The extractive industry declined by 25.4% yoy. Production of coke and lignite decreased by 56.1% yoy, while extraction of crude oil and natural gas declined moderately by 6.1% yoy.

Manufacturing declined by 21.4% yoy due to drop in output in most sectors. Weak external demand resulted in decline of metallurgy and chemical production at 25.7% and 23.5%, respectively. Chemical industry was negatively affected by increase in prices for gas and restricted access to this essential for production input. Drop in machine-building production (by 25.8% yoy) is attributed to low domestic and external demand. In particular, production of vehicles decreased by 84.5% yoy and production of locomotives dropped by 74.8% yoy. Food production (excluding tobacco and beverages) contracted by 17.4% yoy primarily due to lower access to Russian market.

Production and distribution of electricity dropped by 15.0% yoy due to decline in manufacturing as well as possible impact from implementation of energy saving measures.

In April, drop in retail trade by enterprises reached 29.6% yoy. This reflects decline in private final consumption due to lower real disposable income.

Construction in April dropped by 38.2% yoy due to military conflict, financial constraints faced by companies and low fiscal capital outlays.

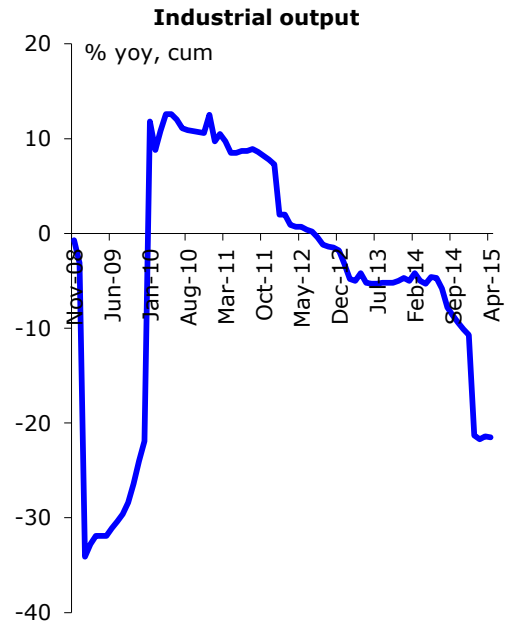
Between January and April freight turnover declined by 21.5% yoy due to logistic problems caused by military conflict in the East and reduction of trade.

**Energy sector: Donbas was cut off from the Joint Energy System**

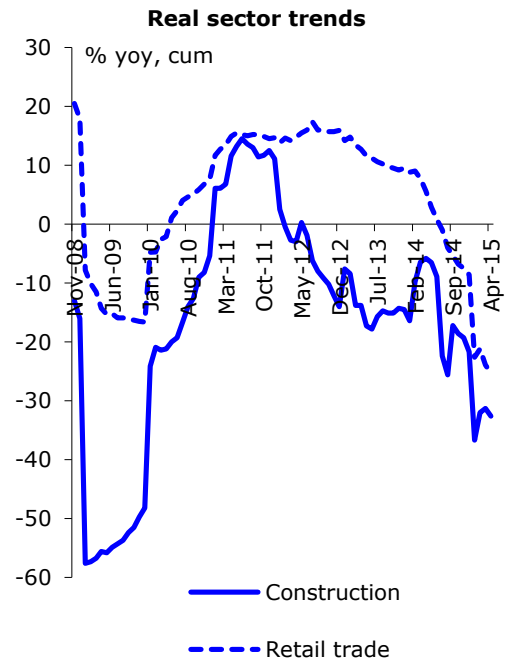
**Electricity.** The Cabinet of Ministers in May excluded energy producers operating on the territory not controlled by the Ukrainian government from the Joint Energy System of Ukraine and offered these producers to sell the energy directly to local suppliers. Dispatching and control of electricity flows will be performed by Donbas Electricity System, a subdivision of Ukrenergo. Any sale of electricity between the uncontrolled territory and the rest of Ukraine is forbidden except for electricity overflows. The Government had to adapt these measures to prevent the unaccountable and unpaid use of the resources.

**Gas.** The Verkhovna Rada allowed the Naftogaz to auction claims for the debts of natural gas consumers, shortened the moratorium period on bankruptcy of energy companies to September 1, 2015 from January 1, 2016, and introduced special accounts for payments for thermal energy produced from natural gas. These measures aim to reduce arrears for natural gas payments by utility companies.

In June, the National Commission for State Energy and Public Utilities Regulation (NERC) decreased the marginal price of gas for industrial consumers by 3% to UAH 6600 per thousand cubic meters (tcm). The



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



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Source: Ukrstat

change in price came as a result of falling gas prices in Europe. Overall, in the first quarter of 2015 the weighted average price of imported gas decreased by 13% qoq to USD 315 per tcm. At the same time, the price of gas purchased in Europe by the Naftogaz decreased by 15% qoq to USD 301 per tcm.

Gas consumption in April decreased by 20% yoy to 2.33 bn cubic meters (bcm) due to the decrease of industrial output especially in gas intensive chemical and steel industries.

**Coal.** Coal extraction in April decreased by 55% yoy to 2.2 m t and coal consumption fell by 30% yoy to 3.6 m t. The amount of coal stored at thermal power plants (TPPs) increased in May by 28% mom but is still 3 times less than a year ago. Thus, Ukraine still has a deficit of coal for electricity generation despite continued coal imports. Lack of coal in storages caused Zmiivska TPP in Kharkiv region to stop operations on May 22. The station had coal for only one energy block which was considered economically unreasonable and the station was stopped. Also on May 22, Slovyanska TPP in Donetsk region was stopped due to the lack of funds to buy coal. It resumed operations on June 2 after it received UAH 60 m from Energorynok.

### Agriculture: End of sowing campaign

**Sowing campaign.** In May, farmers and enterprises completed sowing campaign. According to the Ministry of Agricultural Policy and Food (Minagro), sown area (not including Crimea) under grain and leguminous crops declined by 10.5% or by 1.0 m ha likely due to higher inputs prices and decline in world prices for these crops. At the same time, sown area under sunflower grew by 4.5% or by 0.2 m ha as sunflower remains the most profitable crop.

**Production.** In April 2015, gross agricultural output decreased by 4.1% yoy. Meat production dropped by 7.6% yoy and milk and egg production contracted by 4.0% yoy and 12.1% yoy, respectively. Such decline is likely to be explained by bans imposed by Russia on imports of Ukrainian producers (affecting milk production) as well as increased prices for feed (affecting all animal production).

**Agricultural policy.** In April 2015, the Parliament adopted the Law "About animal by-products". This Law is one of the necessary steps to open EU market for Ukrainian pork and beef producers. According to Minagro, appropriate legislation in this area would enable 79 enterprises to export to the EU. Providing the Law is signed by the President, it will take effect in one year from the publication date.

In May, the Cabinet of Ministers allowed production of bioethanol not only on state plants, but on all plants with the appropriate license. Potentially, this will lead to increase in competitiveness and, thus, growth of production of bioethanol and decline in its price.

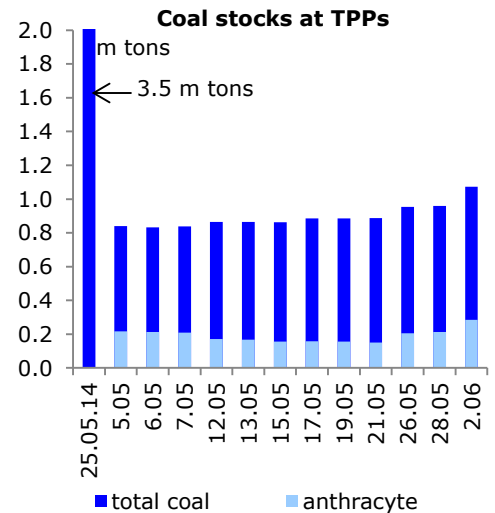
### Privatisation: Big privatisation is planned

On May 12th, the Government approved the list of companies that can be privatised in 2015. The list contains 342 stakes in companies from different sectors. In particular, the list contains such large stakes as Odesa Port Plant (99,567%), Sumyhimprom (99,995%) and Mariupol sea trading port. Besides, the Government plans to sell stakes in power generation companies, including Donbasenergo (25%) and Kyivenergo (25%). However, the sale of most companies especially at fair prices is unlikely this year due to economic uncertainty and unrest in the East.

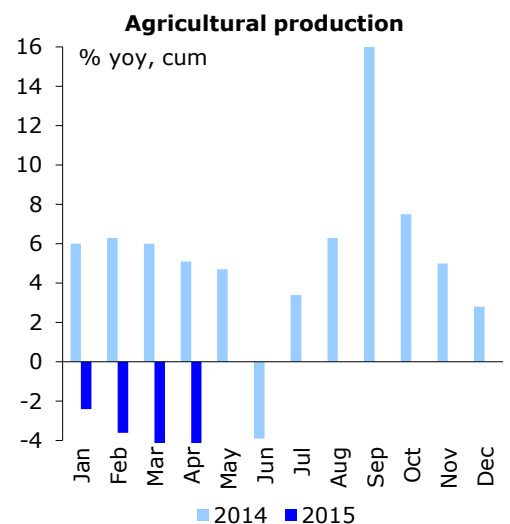
To increase chances for successful privatization in the future the Ministry of Economic Development and Trade is going to improve management on the state enterprises. In particular, according to the intention companies' CEOs will be selected through open competition and their salary will be tied to companies' results.

### External sector: Current account balance was positive

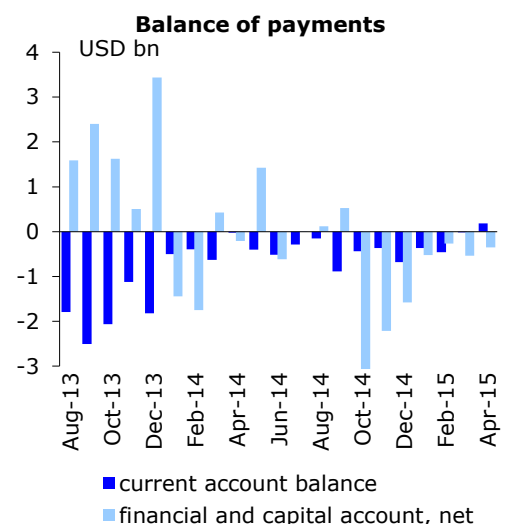
*Current account* in April was positive at USD 0.2 bn as merchandise imports contracted at a faster pace than exports. Merchandise trade was likely close to balance, while trade in services was positive at USD 0.1 bn. Net primary income payments (excluding remittances)



Source: Ukrenergo



Source: Ukrstat



Source: NBU preliminary estimates

remained at USD 0.3 bn as inflow of investments was limited. Remittances were stable at USD 0.5 bn.

Exports of goods dropped by record 39.1% yoy. In particular exports to Russia decreased by 57.8% yoy in April with largest drop of exports of ready food products and machine building. Besides, downward trend at the world commodity markets (primarily cereals, steel and iron ore prices) also decreased value of Ukraine's exports. Finally, Donetsk and Lugansk regions accounted for 23.4% of exports in April 2014, while this share dropped to less than 10% in the first quarter of 2015. This influenced steel, chemical and machine building exports. Drop of exports to EU by 37.4% yoy reflected low grain and steel prices, lower steel production and diversion of steel exports to other countries. Exports of services dropped by 21.8% yoy because of lower exports of transit and outsourcing services.

Decline in imports of goods accelerated to 40.6% yoy as hryvnia depreciation (20.92 UAH/USD in April 2015 vs. 11.63 UAH/USD in April 2014) led to lower consumer demand, higher share of lower-priced imports and import substitution. Restrictive measures on currency purchases and special duty on imports also limited imports. In particular, imports of food products decreased by 53.9% yoy. Termination of investment projects and low private demand for durables led to contraction of machinery imports by 42.6% yoy. Overall imports of industrial products (including chemicals, wood products, industrial goods, metals and machinery) decreased by 37.1% yoy. Imports of mineral products decreased by 29.1% yoy as Ukraine purchased lower amounts of natural gas at lower prices than in the same period of last year. Imports of services declined by 25.8% yoy because of low purchasing power, tighter currency controls and low economic activity.

*Financial and capital account* was negative at USD 0.4 bn. Net FDI inflow was negligible as investment climate did not improve. The deficit of loan and bond operations shrunk to USD 0.7 bn due to lower repayments by banking sector. The Government sector had a positive balance of external debt financing due to the funding by the EU, whereas the real sector still had a restricted access to foreign loans but also negotiated for restructuring of external loans. Amount of foreign cash outside banks shrunk by USD 0.1 bn.

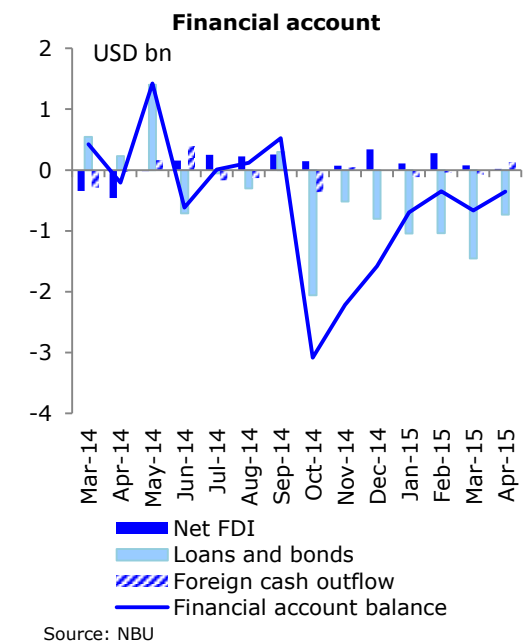
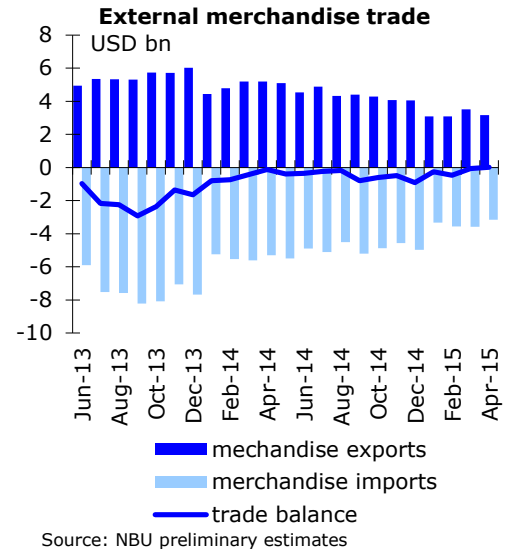
**Fiscal policy: Widened fiscal surplus**

**Preliminary data.** According to the information of the State fiscal service, growth of consolidated fiscal revenues in May sharply decelerated to 19.5% yoy, while in previous two months it exceeded 40% yoy. This is likely to be largely explained by further slowdown in hryvnia imports due to lower domestic demand and imports substitution against the background of hryvnia depreciation.

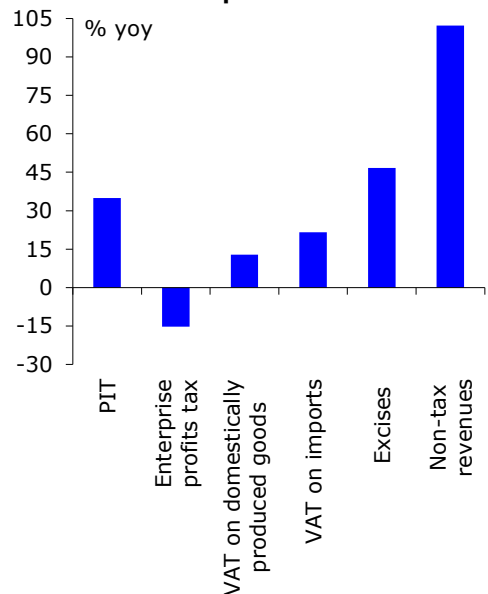
**Execution of revenues.** In April, growth of consolidated fiscal revenues decelerated to 45.9% yoy from 48.8% yoy in March. VAT on imports grew by 16% yoy as compared to increase in imports in hryvnia equivalent (excluding gas imports no subject to VAT) by estimated 19% yoy in April and May. Import duty and excise on imports also decelerated. As a result, consolidated tax revenues grew by 32.2% yoy as compared to 61.2% yoy a month before. At the same time, consolidated non-tax revenues were supported by transfer of the NBU profit to the budget.

**Surplus** At the same time, consolidated fiscal surplus in the first four months of the year widened to UAH 18.0 bn (as compared to UAH 14.0 bn in the first quarter). This likely reflected higher than expected revenues of local budget (UAH 10 bn surplus) and higher than planned revenues of central budget (UAH 13.7 bn for tax revenues). As the Government and local authorities remained conservative with spending targets and nonpriority spending was lower than planned this resulted in substantial surplus.

**Budget resolution 2016.** The Budget committee of Verkhovna Rada submitted the revised Budget resolution for 2016, which is based on the assumption of real GDP growth at 2.0% and CPI increase at 9.0% yoy in December. While GDP forecast is close to the IER estimate,



**Growth of Consolidated fiscal revenues in April 2015**



inflation forecast is more optimistic than ours. The central fiscal deficit is planned at no more than 3.0% of GDP. Subsistence minimum and, thus, minimum wage and minimum pension, is to be increased in line with expected inflation and economic growth.

The Government plans to reduce further cross-subsidisation of passenger transportation as well as sales of gas, electricity and water supply. The tax reform and fiscal decentralization are among priorities for next year. Coal mines are planned to be either privatized or liquidated in 2016, which, if implemented, will complete coalmining reform. The optimization of budget entities in education, healthcare, and culture are expected, which is likely to increase efficiency of fiscal spending. Overall, the Resolution rather generally defines future policies and their aims, which are to be taken into account by the Government while drafting the Budget Law.

### Social policy: Coverage by housing and utility subsidies increased

Between January and April the number of families that applied for housing and utility subsidies (HUS) reached 0.5 m, which is by 2.1 times more than in the same period of last year. Number of HUS recipients in April more than doubled and reached 1.24 m families or 7.8% of all households while average size of subsidy increased by UAH 335 per month. This reflected gas and heating price increase that was effective in May and October 2014.

Preliminary data show that about 0.8 m families applied for subsidies in May, while all existing 1.25 recipients will also be considered for subsidies. Out of the total pool of over 2 million potential recipients about 0.5 m applications were approved, while the checks of income and other provided information is still conducted for other families. The Ministry of Social Policy expects 1-2 million of families to apply for HUS in October after heating season starts.

In the meantime, the Ministry prepares further amendments to the procedure of application for the HUS taking into account drawbacks revealed since April. In particular, changes will relate to income declaration, as many applicants made mistakes while providing the information. The Ministry also claims on the necessity to improve data sharing with the State Fiscal Service and housing and utility companies (the data verification is now a task for social welfare departments as applicants are not required to prove of income).

### Labour market: Improvement in some sectors

**Wage.** Average wage in April grew by 16.5% yoy in nominal terms due to indexation of wages for inflation. Wage decreased by 29.6% yoy in real terms due to acceleration of inflation.

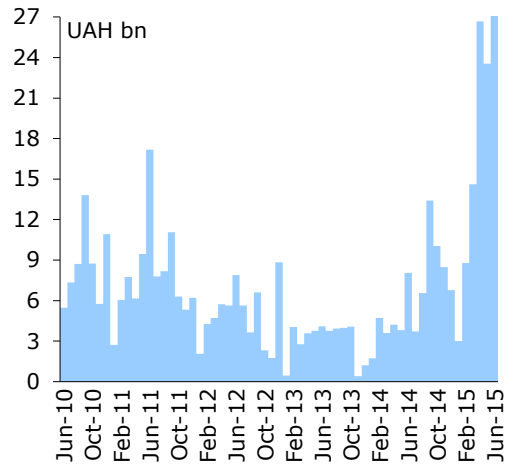
Nominal wage increased more in manufacturing than in extractive industry (by 22.8% yoy and 14.1% yoy, respectively) as manufacturing enterprises were less affected by the military conflict in the East. Several sectors demonstrated sharp increase in wages. In particular, wages in pharmaceutical industry increased by 45.8% yoy, which might be at least partially explained by the change in items produced (production in pharmaceuticals decreased by 16.4% yoy, while revenue rose by 72.4% yoy). Average wage in the production of computers, electronic and optical equipment increased by 53.3% yoy likely as a consequence of increased high value military procurements.

Wage in the agriculture increased by 28.8% yoy likely due to higher revenues from sales of grain crops.

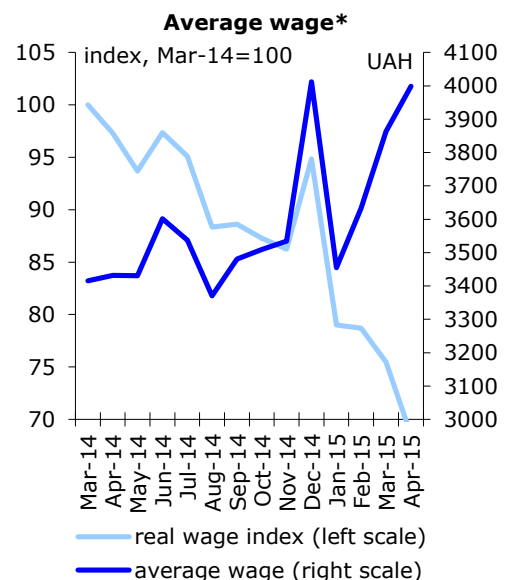
As previously, wage growth was the lowest in public sectors as a result of previously approved decisions to reduce bonuses and premiums and cut basic wages. Consequently, wage in public administration and defence increased by 6.5% yoy, wage in education and healthcare increased by 7.9% yoy and 6.9% yoy, respectively.

**Employment.** Because of Russian occupation of Crimea peninsula, it is not possible to compare changes in employment among sectors. As in the previous year, the highest job creation in the first quarter was in the city of Kyiv (5.4% of average employment in 2014),

**Balance of the Single Treasury Account**



\* in the beginning of month  
Source: State Treasury



\*not including AR Crimea  
Source: Ukrstat

Dnipropetrovska oblast (3.2%), and Kharkiv oblast (2.6%). At the same time, 614.2 thousands employees (3.4% of average employment in 2014) stopped working. As a result, job destruction was by 35.7% higher than job creation.

**Monetary policy: Inflation returns to manageable levels**

*Note: Due to recent error in calculation and flaws in methodology we believe that core CPI that excludes most of problematic components (i.e. gas tariffs, fruit and vegetables among others) is more reliable indicator of inflation in Ukraine than headline CPI.*

In May, monthly core inflation slowed down below 2% (to 1.9% mom) for the first time since August 2014, while annual core inflation also slowed down to 46.5% yoy. Consumer demand remained low and global food prices continued on downward trend helping to stabilize inflation. Inflation expectations somewhat decreased due to three months of low exchange rate volatility. Still, inflation expectations remained at high level and cost increases including labour costs continued to work their way through value chains. This resulted in price increases for many components of consumer basket by 1-3%.

The NBU maintained monetary policy stance unchanged in May. Improved macroeconomic stability helped to stabilize banking sector as bank deposit outflows almost stopped. Bank deposits in national currency increased by UAH 3 bn, while deposit withdrawals in foreign currency were slightly higher. Bank liquidity remained sufficient as the NBU purchased UAH 8 bn in government bonds and transferred large portion of profits to the budget. This was offset by UAH 7.5 bn withdrawn through monetary policy operations.

**Exchange rate: Band goes downward**

In May, interbank exchange rate continued to fluctuate in the band set by the NBU. The NBU signalled interventions at UAH 20.5-22.5 per USD and at UAH 21-23 per USD on different days and exchange rate remained within these bounds. However, foreign exchange market seemed to be better balanced in May. Cash exchange rate was even closer to interbank rate and the NBU for the first time in many months allowed the Naftogaz to cover most of its foreign currency needs on the open market. Besides, net NBU interventions were positive at USD 69 m (i.e. the NBU purchased more foreign currency than it sold including FX sold to the Naftogaz). This previously happened in August 2014 (due to IMF requirements) and in March 2015 (prohibition of most imports for a week and mandatory sales of FX receipts). Improved market balance likely reflected reduced demand for cash foreign currency and equilibrium in current account flows. International reserves reached USD 9.9 bn by the end of May.

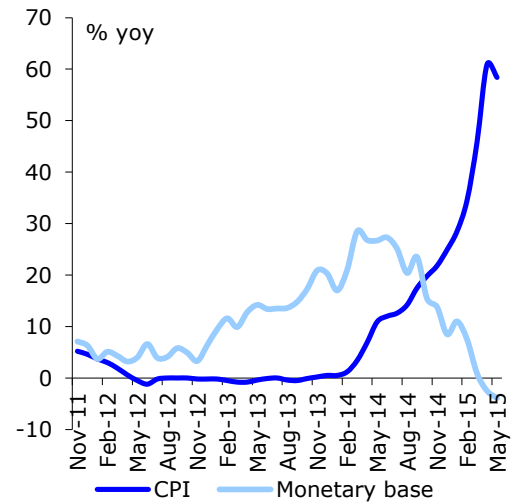
**State debt: Termination of external debt payments**

**Restructuring.** During May the Government continued talks on the restructuring of external state debt with Eurobond holders. The IMF Program envisages three key criteria of successful restructuring. These include decrease in debt service payments (principal and interest) in public sector by USD 15.3 bn in 2015-2018 as, reduction of state debt to 71% of GDP in 2020 and decline in debt service to 10% of GDP between 2019 and 2025. However, so far Ukrainian government did not reach agreement with creditors. Key sticking points are “haircuts” on principal of the debt and suggestions on participation of the NBU in debt repayments.

In the meantime, the Parliament strengthened negotiating position of the Ministry of Finance by allowing the Government to suspend payments on portions of external debt (mostly bonds within the scope of restructuring). At the same time, the Government is likely to continue timely service FX state domestic bonds as well as all official debt.

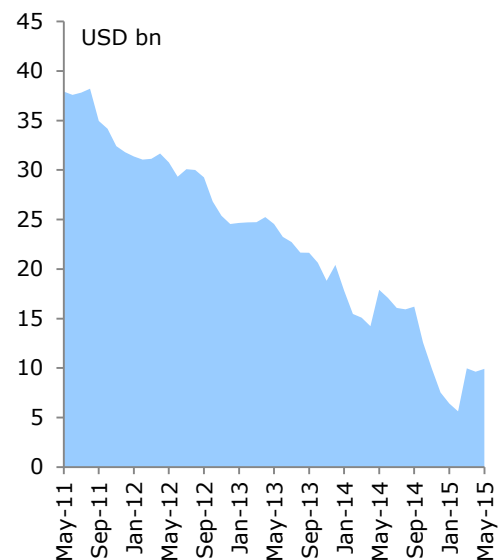
**Eurobonds.** The Ministry of Finance in May conducted placement of 5-year USD 1 bn Eurobonds, which are guaranteed by the US government. The yield was set at 1.847% as compared with US treasury 5-year yield at 1.5% p.a. Similar issue of Eurobonds backed by the USA was completed last year.

**CPI and monetary base development**



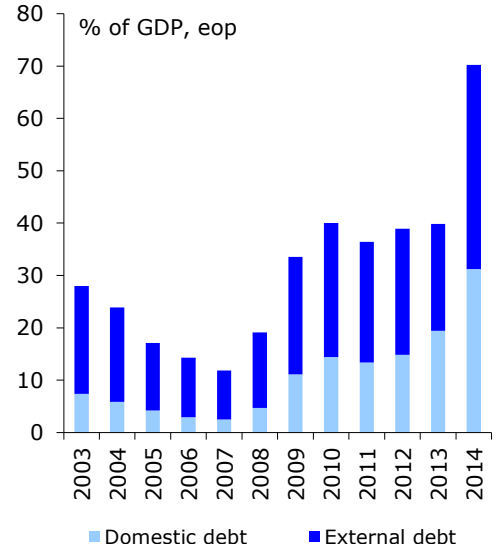
Source: Ukrstat, NBU

**NBU international reserves**



Source: NBU

**State debt**



Source: Ministry of Finance





**VAT bonds.** The State Fiscal Service (SFS) reported over UAH 12.0 bn of VAT refund claims outstanding for various reasons. The amount of overdue refunds is not clear as recent IMF mission noted that all performance indicators were satisfied. These include no new VAT refund arrears. To solve the issue the SFS suggests to issue special VAT bonds, which were already used in the past for three times (each time with the claim that this is just extraordinary event). If the new VAT accounting system is fully functional since July all new VAT refund claims are supposed to be processed automatically and without any delays.

**Tables**

		Q3 13	Q4 13	Q1 14	Q2 14	Q3 14	Q4 14	Q1 15	Jun <sup>c</sup>	Jul <sup>c</sup>	Aug <sup>c</sup>	Sep <sup>c</sup>	Oct <sup>c</sup>	Nov <sup>c</sup>	Dec <sup>c</sup>	Jan <sup>c</sup>	Feb <sup>c</sup>	Mar <sup>c</sup>	Apr <sup>c</sup>	May <sup>c</sup>
Industrial production (real)	% yoy cum.	-5.2	-4.7	-5.0	-4.7	-8.6	-10.1	-21.4	-4.7	-5.8	-7.8	-8.6	-9.4	-10.1	-10.7	-21.3	-21.7	-21.4	-21.5	...
Construction (real)	% yoy cum.	-15.1	-14.5	-6.4	-8.9	-17.2	-19.3	-31.3	-8.9	-22.4	-4.0	-17.2	-18.6	-19.3	-21.7	-36.7	-32.0	-31.3	-32.6	...
Agricultural production (real)	% yoy cum.	3.0	13.7	6.0	-3.9	16.0	5.0	-4.7	-3.9	3.4	6.3	16.0	7.5	5.0	2.8	-2.4	-3.6	-4.7	-4.8	...
Retail trade turnover (real)	% yoy cum.	9.8	9.5	7.7	0.8	-5.3	-7.5	-23.9	0.8	-1.0	-4.0	-5.3	-6.8	-7.5	-8.6	-22.6	-21.2	-23.9	-25.3	...
Average wage	UAH	3331	3390	3245	3488	3463	3508	3641	3601	3537	3370	3481	3509	3534	4012	3455	3633	3863	3998	...
CPI	% yoy eop	-0.5	0.5	3.4	12.0	17.5	21.8	...	12.0	12.6	14.2	17.5	19.8	21.8	24.9	28.5	34.5	45.8	60.9	58.4
PPI	% yoy eop	-0.9	1.7	3.9	15.9	26.9	32.8	...	15.9	22.5	24.2	26.9	25.9	32.8	31.8	34.1	41.0	51.7	48.6	42.0
Exports (USD)*	% yoy cum.	-6.2	-5.2	-7.7	-6.5	-9.8	-13.1	...	-7.3	-7.5	-8.9	-9.8	-11.5	-13.1	-15.0	-30.8	-32.3	-32.9	-34.5	...
Imports (USD)*	% yoy cum.	-4.1	-3.4	-14.7	-18.6	-24.5	-27.1	...	-17.3	-19.7	-22.6	-24.5	-26.3	-27.1	-27.8	-36.3	-35.9	-36.0	-37.2	...
Merchandise trade balance	USD bn cum.	-14.2	-19.6	-1.9	-0.6	-3.6	-5.1	...	-2.5	-2.7	-3.0	-3.6	-4.2	-5.1	-6.1	-0.3	-0.7	-0.8	-0.8	...
Current account**	USD bn cum.	-11.4	-16.4	-1.3	-0.6	-3.3	-4.5	...	-1.9	-2.3	-2.7	-3.3	-4.0	-4.5	-5.2	-0.2	-0.6	-0.5	-0.3	...
Gross international reserves	USD bn eop	21.6	20.4	15.1	17.1	16.4	7.5	10.0	17.1	16.1	15.9	16.4	12.6	10.0	7.5	6.4	5.6	10.0	9.6	9.9
Monetary Base	% yoy eop	14.8	20.3	28.5	25.1	23.5	13.8	0.9	27.3	25.1	20.4	23.5	15.4	13.8	8.5	11.0	7.5	0.9	-2.5	-3.9
Lending rate on UAH credits	% pa, aop	15.3	16.5	18.5	17.5	16.4	16.4	19.87	17.2	16.1	16.8	16.2	16.3	16.7	16.9	17.2	18.8	23.6	23.8	23.6
Exchange rate (interbank)	USD aop	8.15	8.21	9.1	11.71	12.58	13.56	21.23	11.79	11.74	12.98	13.01	12.93	14.75	15.63	15.94	24.77	22.98	22.49	20.97
Exchange rate (official)	USD aop	7.99	7.99	8.9	12.71	12.58	13.56	21.18	11.81	11.76	12.95	13.02	12.95	14.70	15.62	15.81	24.48	23.26	22.71	20.92
Exchange rate (official)	EUR aop	10.58	10.87	12.14	13.71	16.67	17.21	23.88	16.04	15.93	17.25	16.83	16.43	18.36	19.26	18.53	27.78	25.32	24.47	23.32

Sources: Ukrstat, NBU, 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

<sup>c</sup> Data excludes Crimea. Since 2015 the Ukrstat also does not include data for occupied territories in the East of Ukraine

Key Economic Indicators		2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014 <sup>c</sup>
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 <sup>'''</sup>	% 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

<sup>'''</sup> "Minus" denotes a consolidated fiscal deficit; without recapitalisation

<sup>c</sup> Data excludes Crimea

**Notes:**

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



**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](mailto:institute@ier.kiev.ua)  
<http://www.ier.com.ua>

**Head of the Board-Director**

Igor Burakovsky  
[burakovsky@ier.kiev.ua](mailto:burakovsky@ier.kiev.ua)

**Chief Executive**

Oksana Kuziakiv  
[kuziakiv@ier.kiev.ua](mailto:kuziakiv@ier.kiev.ua)

**Academic Director**

Veronika Movchan  
[movchan@ier.kiev.ua](mailto:movchan@ier.kiev.ua)

**Centre for Economic Studies**

Oleksandra Betliy  
[betliy@ier.kiev.ua](mailto:betliy@ier.kiev.ua)  
Vitaliy Kravchuk  
[Kravchuk@ier.kiev.ua](mailto:Kravchuk@ier.kiev.ua)  
Iryna Kosse  
[kosse@ier.kiev.ua](mailto:kosse@ier.kiev.ua)  
Kateryna Furmanets  
[furmanets@ier.kiev.ua](mailto:furmanets@ier.kiev.ua)  
Artur Kovalchuk  
[kovalchuk@ier.kiev.ua](mailto:kovalchuk@ier.kiev.ua)  
Dmytro Naumenko  
[naumenko@ier.kiev.ua](mailto:naumenko@ier.kiev.ua)  
Mykola Ryzhenkov  
[ryzhenkov@ier.kiev.ua](mailto:ryzhenkov@ier.kiev.ua)  
Kostiantyn Kravchuk  
[k.kravchuk@ier.kiev.ua](mailto:k.kravchuk@ier.kiev.ua)  
Oleksa Stepaniuk  
[stepaniuk@ier.kiev.ua](mailto:stepaniuk@ier.kiev.ua)  
Victor Grechyn  
[grechyn@ier.kiev.ua](mailto:grechyn@ier.kiev.ua)

**Center for Contemporary Society Studies**

Iryna Fedets  
[fedets@ier.kiev.ua](mailto:fedets@ier.kiev.ua)  
Tetiana Oliinyk  
[oliinyk@ier.kiev.ua](mailto:oliinyk@ier.kiev.ua)

**German-Ukrainian Agricultural Policy  
Dialogue**

Yuliya Ogarenko  
[ogarenko@ier.kiev.ua](mailto:ogarenko@ier.kiev.ua)  
Mariya Yaroshko  
[yaroshko@apd-ukraine.de](mailto:yaroshko@apd-ukraine.de)

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