INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING

Monthly Economic Monitor Ukraine

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EXECUTIVE SUMMARY

HIGHLIGHT: DCFTA IMPLEMENTATION

Politics: Regardless agreement negotiated on September 5 between representatives of Ukraine, Russia, Donbas militants, and the OSCE pro-Russian militants continued attacking Ukrainian troops in a number of places.

Real Sector: Industrial output in August contracted sharply by 21.4% yoy mainly due to the military conflict in Donbas.

Energy sector: Ukraine is engaged in three-party gas negotiations with Russia and the EU. However, the final solution on gas price, debts redemption and gas transit is still to be found.

Agriculture: Higher grain harvest is likely to result in exports growth. However, Ukraine has already fully utilized quota granted by the EU for duty-free imports of wheat and wheat flour, as well as corn.

External sector: Balance of payments was balanced in August due to surplus of merchandise trade and public sector borrowings.

Fiscal policy: Central fiscal revenues in September dropped by 7.2% yoy. As a result, the Government had to cut discretionary spending. Overall, it will be difficult for the Government to execute the budget fully this year.

Social policy: According to preliminary plans social standards in 2015 will be increased at a lesser extent than officially projected inflation. As a result, purchasing power of many households will reduce further.

Labour market: Average wage in August dropped by 12.7% in real terms due to military conflict in the East, economic downturn, high fiscal pressure and acceleration of inflation.

Monetary policy: In September prices increased for almost all categories of goods and services by 2-5% mom. This was a result of fast transmission of exchange rate volatility that started in August.

Exchange rate: In September exchange rate of hrvynia remained volatile and fluctuated in UAH 12-15 per USD despite NBU sales of foreign currency on auctions, new rounds of administrative restrictions and direct pressure on banks.

State debt: In September Ukraine received the first tranche of sixteen-year loan from the World Bank at USD 500 m in the framework of the first development policy loan.

Highlight of the month: DCFTA Implementation

DELAY IN DCFTA IMPLEMENTATION: TACTICAL GAIN OR LOSS?

Veronika Movchan

On September 12, 2014, trilateral ministerial meeting of the EU, Ukraine and Russia produced quite unexpected decision to postpone the implementation of the EU-Ukraine DCFTA (Title IV of the Association Agreement) till January 1, 2016. It was explained by the need to support the crisis-ridden Ukrainian economy and to continue consultations with Russia regarding its concerns over the impact of the DCFTA on the Russian economy.

The decision expressed in the Joint Ministerial Statement[1] contained several important provisions regarding the postponement of the 'provisional application':

- It is to become possible only after the ratification of the Association Agreement. It was a clear sign that the EU and Ukraine are not ready to change the text of the Agreement in response to the Russian enquiries;
- It is to be accompanied with the prolongation of the autonomous trade measures (ATMs) that the EU granted to Ukraine in April 2014. Thus, the access to EU market remains duty-free for the majority of the Ukrainian exporters;
- It is done based on understanding that Russia will continue to apply preferential CIS FTA in trade with Ukraine.

Taken at face value, the arrangement is moderately beneficial for Ukraine. The ATMs set duty-free regime for 95% of industrial products and 84% of agricultural goods, and duty-free tariff rate quotas for the rest of agricultural goods, which favours Ukrainian exporters. Moreover, the Ukrainian business will get additional time for modernisation and improvement of competitiveness before Ukraine will start gradual elimination of its import duties in trade with the EU.

The postponement of the DCFTA also seems to give Ukraine some (uncertain) time to prepare for eventual increase in tariff barriers for exports to Russia. The latter officially announced that the establishment of the DCFTA between Ukraine and the EU will be considered as a threat for the Russian economy, and that it will retaliate by withdrawing duty-free preferences for a part of Ukrainian exports. The list of goods, to which the MFN rate (the rate used among WTO members) will be applied, include a wide range of agricultural and industrial products, e.g. meat, dairy products and vegetables, chemical industry products, textile products, machinery and equipment. Together, it concerns about a quarter of Ukrainian exports to Russia. On September 19, 2014, the Government of Russian Federation passed Resolution #959, explicitly linking the introduction of the MFN regime for imports from Ukraine with the practical implementation of the DCFTA by Ukraine. As it is unclear what activities will be considered as the practical implementation, the elimination of free trade for a part of the Ukrainian exports to Russia can happen any time in 2014 or 2015. Ambiguity regarding Russia retaliation will end in 2016 as the provisional application of the DCFTA will trigger the implementation of Resolution #959.

Drawback of the arrangement includes delayed further opening of the EU market, namely elimination of all import duties on industrial products, additional reduction in import duties on agricultural goods and expansion of tariff rate quota volumes. The ATMs replicate the schedule of trade liberalization of the first year of the implementation of the Association Agreement, and hence the prolongation of the ATMs means that there will be three 'first' years of the DCFTA – in 2014, 2015, and 2016 (assuming no further delays). In addition, Ukrainian business and consumers will have to wait longer for gains associated with the DCFTA, like increased variety, or relatively cheaper imports of both capital and consumer products.

Major risk in the DCFTA delay is how it will affect harmonization of legislation, constituting backbone of the Association Agreement. According to the Decision of the Council of the European Union, provisional application of majority of the Agreement, including economic and sectoral cooperation, starts already in 2014. It means that harmonization with the EU *acquis* in such spheres as environment, consumer protection, social policy etc. can continue without delay and, hopefully, without pressure of Russia's retaliation. However, harmonization of legislation in areas most acute for the Ukrainian economy and for access to the EU market, namely TBT, SPS, customs, intellectual property rights protection, public procurement, and competition, might be delayed due to possible Russia's retaliation.

In this situation, it is important for Ukraine to withstand this retaliation pressure, and to proceed with reforms. It seems to be understanding between the EU and Ukraine that in case of Russia's retaliation until 2016, the provisional application of DCFTA will be introduced immediately. The IER estimates prove that the establishment of the full-scale DCFTA between Ukraine and the EU is definitely a better option for the economy, even if the FTA with Russia is lost.[2]

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1 http://europa.eu/rapid/press-release_STATEMENT-14-276_en.htm

2 http://www.ier.com.ua/files//Projects/2013/EU_Ukraine/presentation_DCFTA_2014-09-16_EN%20%281%29.pdf

Monthly Economic Monitor Ukraine

Politics: War in Donbas turns into a frozen conflict

The war in the East. On September 5, representatives of Ukraine, Russia, Donbas militants, and the Organization for Security and Co-operation in Europe (OSCE) signed a protocol on a permanent ceasefire in the war in Donbas, which was de facto an undeclared Russian-Ukrainian war. Following that, the intensity of fighting subsided significantly, although pro-Russian militants continued attacking Ukrainian troops in a number of places. Still, the front line remained almost unchanged during the month. Ukraine made steps towards a political settlement of the conflict by passing two laws that allow for granting additional powers to local authorities in some areas of Donbas, as well as exempting a part of militants from criminal responsibility. However, the pro-Russian militants almost did not take reciprocal steps.

Ukraine agreed to a ceasefire because it faced a full-scale war with Russia, which Ukraine was unlikely to win. Such decision also complied with recommendations of Western countries. Currently, the war has two main outcomes for Ukraine. First, Ukraine lost control over a part of its territory for an indefinite period of time. The militants control an area of approximately 16,000 sq kilometres (2.7% of the total area of Ukraine including Crimea), which hosts several large industrial agglomerations (including the cities of Donetsk and Luhansk). Near 3.7 m people lived in this area as of January 1, 2014 (8.5% of the population of Ukraine). Second, war in Donbas is going to turn into a frozen conflict (it will become a reality if active armed conflict is brought to an end). If a frozen conflict within the boundaries of Ukraine is established, it will increase uncertainty about the future of the country as the Donbas quasi-state may be used as a foothold for further aggression by Russia, and as a base for terrorist attacks. Ukraine will also face substantial costs that will come from efforts to curb those threats.

The EU. On September 16, the Verkhovna Rada of Ukraine and the European Parliament ratified the Association Agreement (AA) between the EU and Ukraine, which was finally signed in June. 80% of the current members of the Verkhovna Rada voted for ratification (355 out of 445). However, the entry into force of an essential part of the agreement was postponed. Following negotiations between the EU, Ukraine, and Russia for peace in Donbas, the Council of the European Union delayed the provisional application of the part of the agreement that covers trade and related matters, including the establishment of a deep and comprehensive free trade area. As a result, the AA will come into force in three stages: (1) most provisions on justice, freedom, sector cooperation, and financial cooperation will become effective on November 1, (2) the chapters on trade and related matters will enter into force on January 1, 2016, and (3) the remaining part of the agreement will come into force when it is ratified by all 28 EU member states, which may take up to 3 years.

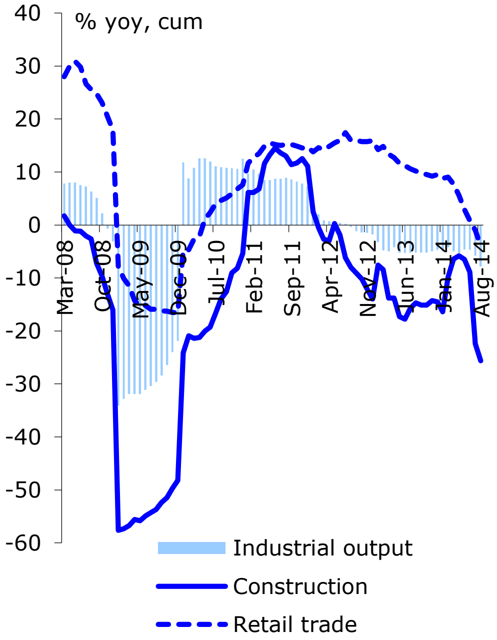
Population: 45.5 m
Industry/GDP: 23%
Agriculture/GDP: 10%
Investment/GDP: 18%
Exports to: Russia 24%, EU 26%
Imports from: Russia 30%, EU 35%

Real sector: Military conflict results in economic downturn

Sectoral trends. Industrial output in August contracted sharply by 21.4% yoy mainly due to the military conflict in Donbas. Many companies in the region have terminated or stopped their operation. Some companies in other regions, e.g. steel plants, had logistic or supply problems. In particular, many mines in Donbas were forced to terminate their operation in August, which resulted in contraction of the extraction of coke and lignite by 60.4% yoy, which caused lack of sufficient coke supplies to metallurgical plants.

Output declined by19.6% yoy in chemical production and 30.0% yoy in metallurgy. Trade tensions with Russia and weak domestic demand contributed to a decline in machine building by 31.0% yoy. The largest drop was in the manufacture of vehicles and manufacture of locomotives (by 82.4% yoy and 71.1% yoy, respectively). Overall, output in manufacture dropped by 19.2% yoy.

Real sector trends



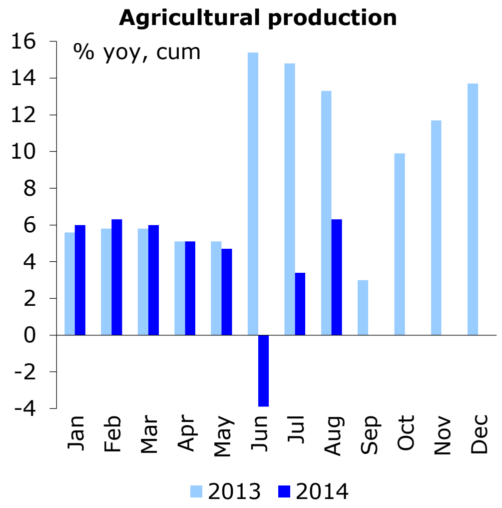
Note: Since April 2014 - data excludes Crimea
Source: Ukrstat

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

In August retail trade by enterprises dropped by 17.1% yoy, which reflects decline in real private final consumption.

Sharp drop in construction (37.1% yoy in August) may be explained primarily by military conflict in Eastern Ukraine and financial constraint faced by companies. Moreover, fiscal capital outlays were also lower than planned due to high fiscal pressure.

Agricultural production in August increased by 13.6% yoy primarily due to higher yields of most crops.



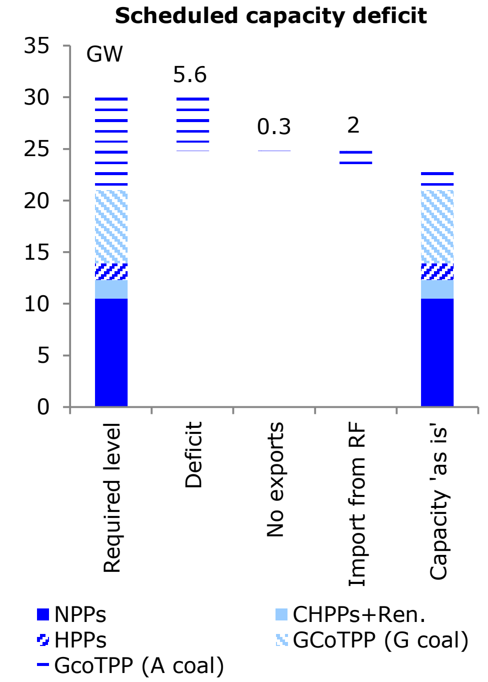
Source: Ukrstat

Energy: Ukraine and Russia resumed gas negotiations

Gas. In September, Ukraine imported around 1 bcm of gas compared to 0.25 bcm in August due to purchases via Slovakia. According to the Energy Ministry, average price of gas through Slovakia and Poland was USD 350 per thousand cubic meters. At the same time, the Gasprom decreased gas supplies to several European customers, which caused some disruption in reverse gas flows to Ukraine.

Currently, Ukraine is engaged in three-party gas negotiations with Russia and the EU, which started on September 26. According to the preliminary results, Ukraine agreed to pay half of its debt (estimated by the Gasprom at USD 5.2 bn) and additional USD 1.9 bn for 5 bcm of guaranteed gas supplies and 5 bcm of gas option. Therefore, the temporary price of Russian gas for Ukraine is set at USD 380 per thousand cubic meters. The Naftogaz continues to discuss with Gasprom the settlement on the temporary price and gas transit agreement. An agreement with the Gasprom will allow Ukraine to pump into storages 5 bcm of gas crucial for ensuring heating during the winter season.

Coal and electricity. According to the National Commission for State Energy and Public Utilities Regulation, coal reserves at thermal power plants (TPPs) reduced to critical levels of 0.5 m tones as of September 26. The lack of domestically extracted coal requires the Government to look for opportunities to import coal. However, according to the DTEK, coal and electricity imports will not ensure maximum electricity production at high demand in winter if Kryvorizka, Prydniprovska, Luganska, Starobeshevska and Zmiivska TPPs are not running. Those five TPPs account for 8560 MW of electricity (28% of the winter nonindustrial daily maximum electricity consumption) and use anthracite (A grade coal) extracted mostly in the Donbas region of Ukraine.



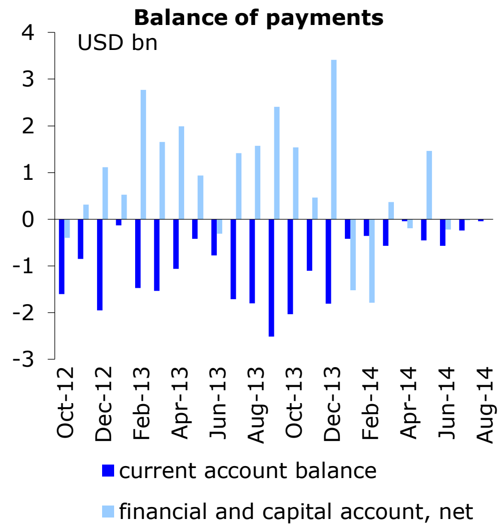
Note: TPP - Thermal Power Plant, CHP - Combined Heating Plant, HPP - Hydro Power Plant

Source: DTEK

Agricultural sector: Grain market and institutional reforms

Grain harvest and exports. According to the Ministry of Agricultural Policy and Food, 41.8 m t of grains and legumes were harvested at the area of 11.2 m ha (75% of total area) by the end of September. Average yield increased by 14% to 37.4 quintals per ha. The highest grain yields at about 53, 51, 50 quintals per ha were recorded in Khmelnitsky, Cherkasy and Chernivtsi regions.

In the first three month of new marketing year (from 1st of July) 8.7 m t of grains were exported or prepared for exports (5 m t of wheat, 2.9 m t of barley and 0.6 m t of corn). Notably, Ukraine has already fully used granted by the EU quota for duty-free imports of 950 thous. t of wheat and wheat flour, 400 thous. t of corn, which was provided for the period from 1st of April to 31st of October. As demand for Ukrainian barley from European importers is weak (only 8% of quota is used) the EU Commission extended the quotas for barley by the end of the year.



Source: NBU preliminary estimates

Institutional reforms. In September the Cabinet of Ministers reduced the number of central executive bodies that perform different functions related to implementation of agricultural policies. The State Inspectorate of Agriculture was abolished and its functions were transferred to other institutions. In particular, registration and accounting of agrimachinery will be now managed by the Ministry of Agricultural Policy and Food, functions of state supervision (control) of operation and maintenance of machines were shifted to the State Inspectorate on Transport Safety. In addition, functions of state control over implementation of land laws, land use and protection of all types and forms of ownership, soil fertility were assigned to the State Ecological Inspectorate. At the same time, the State Service for Food Safety and Consumer Protection was established based on liquidated the State Inspectorate for Consumer Protection, the State Sanitary and Epidemiological Service, the State Veterinary and Phytosanitary Service. Above mentioned institutional reforms should improve conditions for doing business in Ukraine as restructuring of government bodies is combined with simplification of administrative procedures.

External sector: Balance of payments was balanced in August

Current account deficit in August was less than USD 0.1 bn. While merchandise trade balance was positive at USD 0.1 bn, services trade balance was negative at USD 0.1 bn due to lower travel and transport services exports.

Exports of goods declined by 17.3% yoy reflecting disruptions in production due to military conflict in Donbas and further trade tensions with Russia. Exports of chemicals declined the most (by 40.7% yoy) as several enterprises in the East of Ukraine stopped operation due to military conflict. Sharp contraction of machinery exports (by 37.2% yoy) was explained by lower demand for locomotives by Russia as well as trade restrictions for these goods imposed by both Russia and Ukraine. Food products was the only group that demonstrated increase in exports (by 4.2% yoy) due to larger shipments of wheat and limited positive effect of autonomous trade preferences by the EU primarily on poultry.

Imports of goods declined by 42.4% yoy. Consumption and investment demand for imported goods dropped due to decline in households' income and financial constraints of companies. Sharp hryvnia depreciation resulted in imports substitution. As a result, imports of all product groups declined with a major drop for machinery and minerals. Minerals imports drop accelerated as Ukraine imported gas only from Europe with lower than usually volumes. Imports of minerals was supported by purchases of coke.

Financial and capital account was balanced. Net FDI inflow was positive but low. Outflow of foreign cash outside banking system remained at USD 0.2 bn. Ukrainian banks and real sector attracted less short- and long-term loans than they had to repay. On the other hand, net balance of loans and bonds operations of the government was positive as it was able to attract contracted debt financing from international donors and partners.

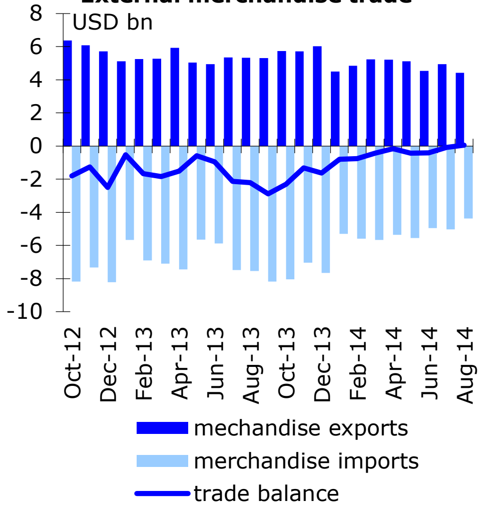
Fiscal policy: Fiscal pressure increases

Note: *The State Treasury reported on-going settlement of VAT refund arrears with government bonds as cash refund of VAT. In our opinion this is incorrect (it is more properly accounted for as reduction in payables) and we adjusted data from Treasury reports to exclude the effect of VAT refund arrears settlement on budget revenues.*

Preliminary data. According to preliminary data of the State Treasury total central fiscal revenues (before VAT refund) in nine months of 2014 reached UAH 301 bn and were by 6.3% lower than target. In particular, tax revenues were likely lower than planned due to larger decline in economic activity than assumed in budget planning. Under-execution of non-tax revenues is attributed primarily to lower own revenues of budget entities (special fund of the budget). At the same time, the Treasury refund VAT by special government bonds issue at UAH 6.7 bn.

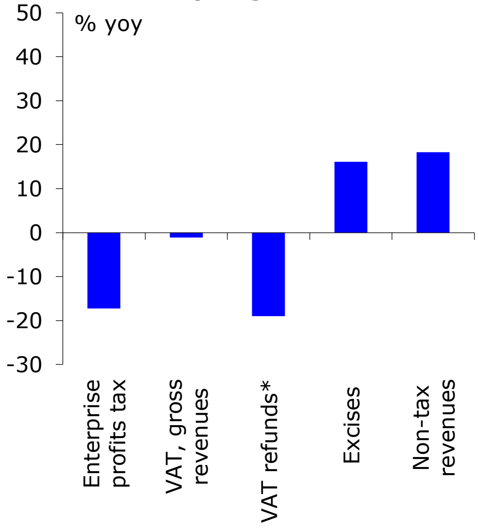
Central fiscal revenues in September dropped by 7.2% yoy. This is explained by frontloading of NBU profit transfer to the budget in previous months, while in September 2013 this transfer at UAH 5 bn ensured 15.1% of revenues. Still, tax revenues increased this month due to lower cash VAT refunds as well as additional revenues from recent tax increases (e.g. introduction of military fee, increase in excise and rent payment rates) as well growing imports in hryvnia

External merchandise trade



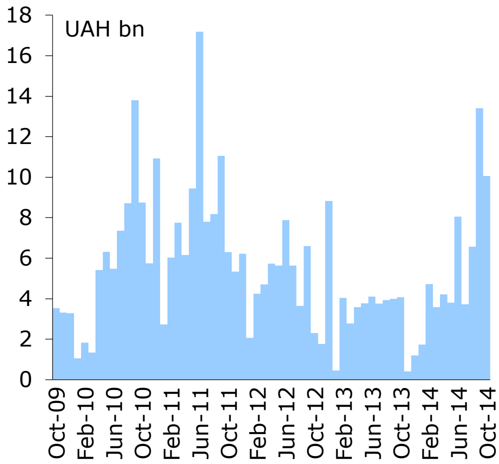
Source: NBU preliminary estimates

Growth of central fiscal revenues January-August 2014



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

Balance of the Single Treasury Account



* in the beginning of month
Source: State Treasury

terms. However, it will be difficult for Government to execute the budget fully this year.

8 months. Central fiscal revenues in eight months of 2014 grew by 8.7% yoy. In particular, tax revenues grew by 3.2% yoy as in August military tax, elimination of some tax privileges, increase in excise rates and rent payments as well as some tax administrative measures became effective. VAT revenues grew by 6.5% yoy due to lower VAT refunds (which might signal about increase in VAT refund arrears) and higher VAT paid on imports (due to hryvnia depreciation). Higher collections of excise duties (at 16.1% yoy) are attributed to increase in rates as well as hryvnia depreciation. This offset the sharp drop in EPT collections. At the same time, growth of non-tax revenues decelerated to 18.3% yoy (from 34.1% yoy in seven months of the year) due to ceased NBU transfer of profits to the budget, which was paid in previous period.

Central fiscal deficit (without recapitalization of banks and companies) reached UAH 35.2 bn and was lower than planned. In particular, privatisation receipts reached only 0.7% of target for this period. Lower than planned financing resulted in under-execution of central fiscal expenditures (general fund) by 7.6% of target. Financing of defence items was by 28.3% lower than planned due to unsuccessful tenders. At the same time, social protection and other protected spending articles were financed almost fully.

Budget 2015. The Government did not submit the State Budget Law for 2015 to the Parliament in September, though it is required by the Constitution. The Government blamed Verkhovna Rada for not approving amendments to the Tax and Budget Codes, which were supposed to become a base for the Budget Law. In particular, the Government suggested to reduce number of taxes, reduce social unified tax rate for high wages and expand and liberalise use of simplified taxation. Such amendments were officially expected to bring additional revenues due to de-shadowing of economic activity and wage payments. At the same time, military tax as well as hikes in rent payment fees and excise duties, which were previously approved only for the end of 2014, were to remain effective in 2015. The amendments to the Budget Code envisaged shifts in responsibilities and revenues between central and local budgets. Though proposed changes were labelled as "decentralisation" they envisaged withdrawing large part of personal income taxes to central budget and replacing them with newly introduced property taxes and local excise surcharges on tobacco and alcohol.

It is very likely that the State Budget Law for 2015 will be submitted to the Verkhovna Rada only after new Government is appointed after Parliament elections, scheduled for October 26.

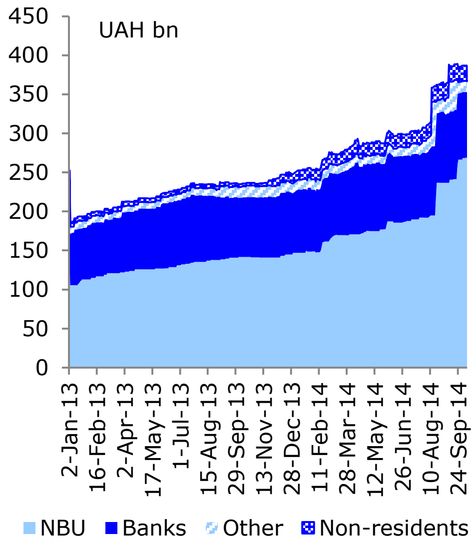
Social policy: Decline in purchasing power

Households' income. Disposable households' income in the second quarter of 2014 grew by 7.9% yoy in nominal terms but declined by 1.9% yoy in real terms. In particular, nominal wage income increased by only 3.7% yoy due to deceleration of average wage growth and increased unemployment. Increase in social standards, including pensions, resulted in growth of income from social assistance by 7.8% yoy. Good crop harvest and higher inflation resulted in increase in nominal income from entrepreneurs activity and subsidiary farming by 10.2% yoy. As a result, share of wage income in total income declined by 1.4 p.p. to 40.8%.

Social standards in 2015. According to preliminary plans subsistence minimum, and, thus, minimum wage and minimum pension, will be increased by 3.4% on average in 2015 and 5.4% yoy in December. Such decision is explained by further fiscal consolidation. Taking into account that inflation will remain at two-digit level, purchasing power of most Ukrainians is likely to decline next year.

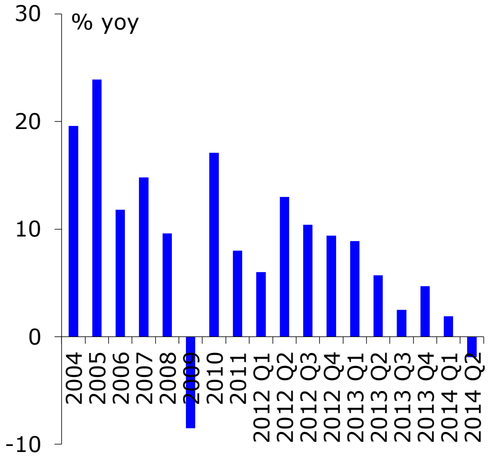
Subsidies. Since October 1, changes to state social housing and utility rules came into force. In particular, the Government revised norms of housing size, use of gas and water, electricity consumption.

Domestic government bond holdings



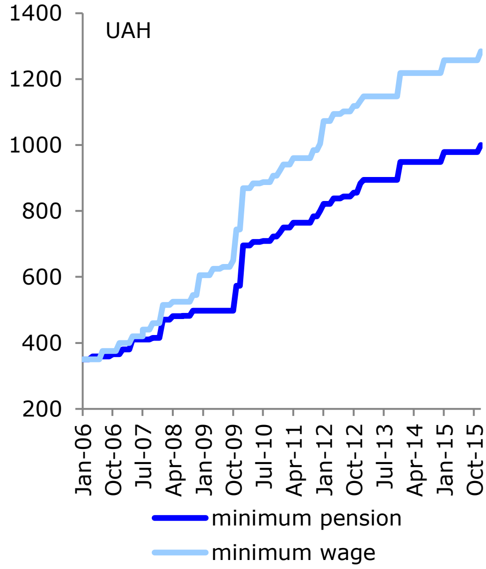
Source: NBU

Real disposable household incomes



Source: Ukrstat

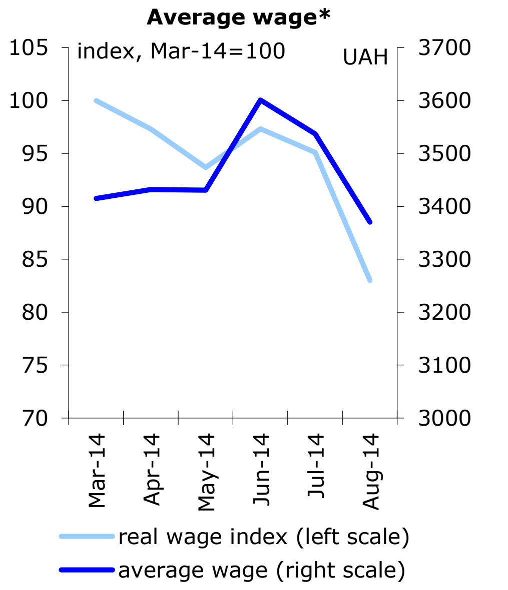
Social standards



Source: State budget laws for 2006-2014, preliminary goverment plans for 2015

Consumption standards are based on such characteristics as availability of centralised supply of hot water. Means-testing of the subsidies will be through indirect means, i.e subsidies are not approved if there are large recent asset purchases and other indicators of high social standing.

At the same time, the Government added direct means testing to subsidies. In particular, previously housing and utility bill was capped by 15% of households' income (10% for households of pensioners, disabled individuals and children), which was paid by households, while the rest was covered by direct money transfer from budget to utility companies. Now, cap on utilities spending depends on income size. Households with per capita income at the level of subsistence minimum will need to spend 7.5% of income on utilities, while middle income earners at 4 subsistence minimums per person will have to spend over 30% of their income on utilities for the subsidies to trigger. Given limits on coverage subsidies might be received by middle class recipients in case of large number of children and if they have large homes heated by gas. Such change in subsidy provision favours more poor households, which leads to more targeted subsidies. In case of tariff increases subsidies will still act as a buffer for less poor households. However, combination of direct and indirect means testing may cut off some deserving households from subsidies.



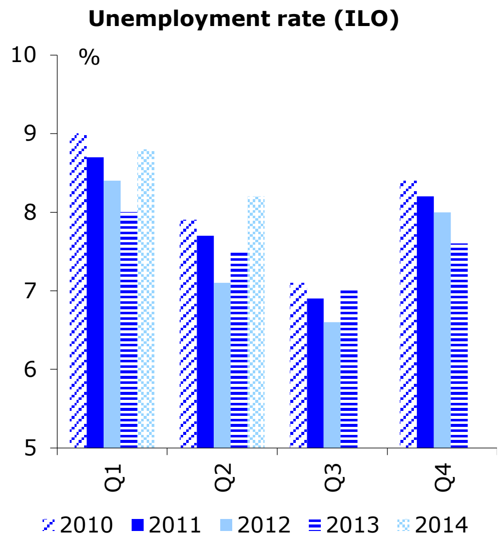
*not including AR Crimea
Source: Ukrstat

Labour market: Wages are still falling

Wage. Average wage in August grew by only 1.5% yoy in nominal terms and dropped by 12.7% in real terms. The reasons for drop in real wages remained unchanged and include military conflict in the East, economic downturn, high fiscal pressure and acceleration of inflation.

Average wage in industry grew by mere 1.0% yoy, which is lower than minimum wage increase (at 6.2% yoy). At the same time, wage trends in industrial sectors differed. Wages grew primarily in domestically oriented sectors. In particular, wages grew by 5.6% yoy in food industry, 8.2% yoy in textile industry, and by 9.8% yoy pharmaceutical industry. Still, none of the sectors demonstrated a positive real wage increase.

Good harvests of grain and other crops resulted in increase of nominal wages in agriculture by 9.0% yoy. Wages in information and telecommunication sector grew by 14.4% yoy, making IT sector the only one with the real wage increase. Fiscal consolidation measures resulted in decline of wages in public administration and defence (by 9.9% yoy), education (by 0.6% yoy) and health care (by 0.8% yoy).

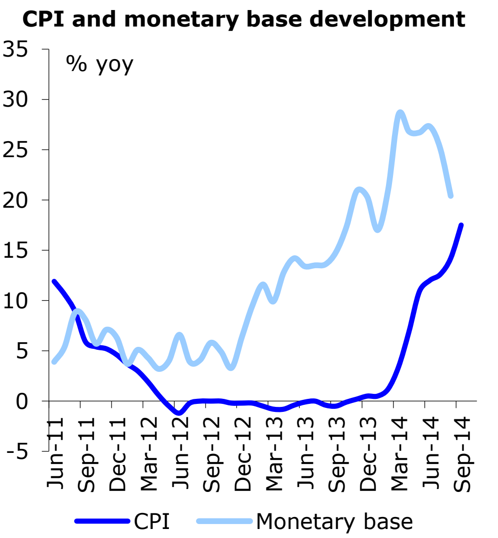


Source: Ukrstat

Unemployment. Unemployment rate of economically active population in age of 15-70 (ILO methodology) increased to 8.2% in the second quarter of 2014 as compared to 6.9% in the same period of last year. With the continuation of economic slowdown, employers had to reduce the number of employees regardless increase in staff shifted either to unpaid leave or reduced working week.

Unemployment rate increased most significantly in Donetsk and Luhansk oblast (by 2.2 p.p. and 3.8 p.p. correspondingly) due to termination of operation or closure of many enterprises. Spillover of armed conflict in Eastern Ukraine heavily affects other parts of the country: unemployment increased in all other parts of the country.

Monetary policy: Inflation jumped to 17.5% yoy in September



Source: Ukrstat, NBU

In September consumer inflation jumped to 17.5% yoy. Prices increased for almost all categories of goods and services by 2-5% mom. This was a result of fast transmission of exchange rate volatility that started in August. Swift impact of exchange rate (as compared to spring) on prices reflects low inventories of imported goods and high inflation expectations. Exchange rate volatility also may have triggered previously planned price increases delayed due to low demand. Month-to-month core inflation (that excludes raw food products, energy, and administratively set prices) increased to 2.7% mom.

Banking system in September retained large volumes of liquidity despite foreign currency sales by the NBU. The NBU bought large amounts of government bonds and allowed banks to delay repaying refinancing owed to the NBU (UAH 110 bn in total). Slower outflow of deposits and weak lending activity likely contributed to comfortable aggregate liquidity position of banks. At the same time, interbank interest rates remained above 10% p.a. due to market segmentation and high rates on NBU deposit certificates.

Exchange rate: Volatility continues

In September exchange rate of hrvynia remained volatile and fluctuated in UAH 12-15 per USD despite NBU sales of foreign currency on auctions, new rounds of administrative restrictions and direct pressure on banks. This could be explained by reduced supply (minimum capital inflows, decreased export inflows) and increased demand (increase in gas and coal imports, possibly seasonal increase in other imports) on the background of clearly insufficient liquidity (in part due to administrative measures such as 100% mandatory sale). Towards the end of the month exchange rate stabilized near UAH 13 per USD through new restrictions on purchases of cash foreign currency (at UAH 3000 per day per individual), retreat from excessive 100% mandatory sale of foreign currency (decreased to 75%), expanded sales of foreign currency to banks by the NBU and concerted pressure from top state officials. Overall, the NBU spent net USD 0.7 bn on interventions to support exchange rate.

NBU international reserves reached USD 16.2 bn as it received USD 2.0 bn from the IMF and other donors. However this increase is temporary as the NBU recently spent reserves on USD 1.6 bn repayment of Eurobond by the Naftogaz.

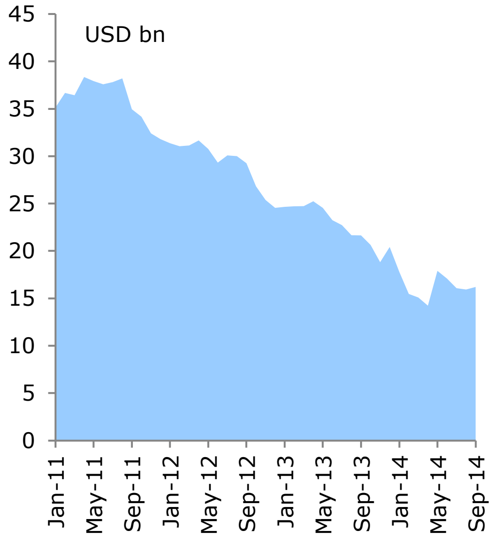
State debt. Next tranches of external financial aid received

Domestic debt. The Ministry of Finance placed only 1.7 UAH bn of hryvnia denominated bonds at the open market. The weighted average yield fell by 1.6 p.p. to 15.9% p.a. likely due to higher share of seven- and ten-year bonds in the total placement (70.6%), which were sold with lower yields. The Government issued only USD 8 m USD-denominated bonds (with yields at 8.1% p.a.) due to low demand. This could mean that the Ministry of Finance had sufficient funds to cover debt repayments (likely at the expense of previously received foreign financial assistance).

In September the Government also issued UAH 22.4 bn of state domestic bonds for the recapitalisation of the Naftogaz. The received funds were likely spent on the redemption of the company's Eurobonds. Besides, the Cabinet of Ministers provided the loan for the Deposit Guarantee Fund in the form of special issue of USD 10.1 bn of state domestic bonds with ten-year maturity at 5% p.p.

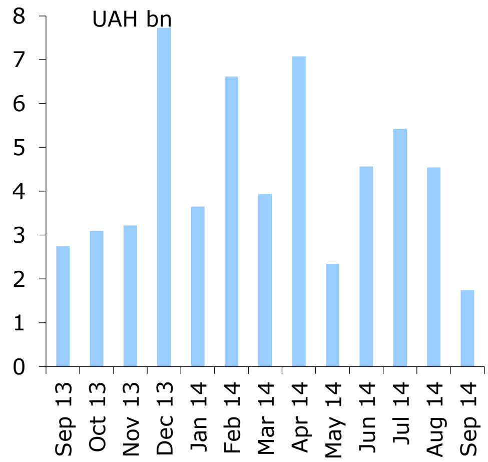
External debt. On September 8, Ukraine received the first tranche of sixteen-year loan from the World Bank at USD 500 m in the framework of the first development policy loan under the agreement signed in August. The funds were granted with seven-year grace period at floating rate (0.63% p.a. as of the signing date) and one-time fee at 0.25% p.a. This loan is to be allocated for priority reforms in the banking sector and implementation of the anti-crisis management program in Ukraine's financial sector. Besides, Canada provided CAD 200 m of five-year loan to Ukraine (at 2.1% p.a.) to promote economic and financial sector reforms.

NBU international reserves



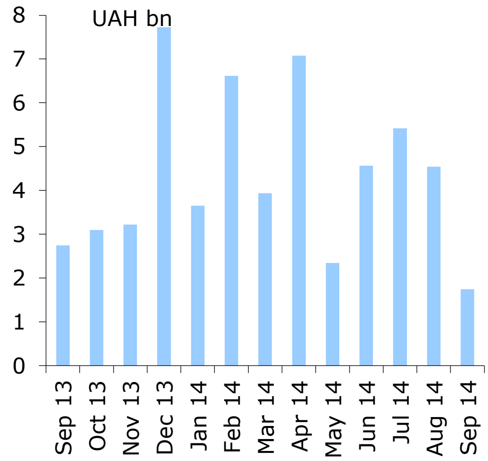
Source: NBU

State domestic bonds placement denominated in UAH*



Source: NBU
*without recapitalisation

State domestic bonds placement denominated in UAH*



Source: NBU
*without recapitalisation

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]	Aug[c]	Sep[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	-5.8	-7.8	...
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	-22.4	-4.0	...
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	3.4	6.3	...
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	-1.0	-4.0	...
Average wage	UAH	3064	3195	3085	3289	3331	3390	3245	3488	3283	3268	3619	3148	3189	3398	3432	3430	3601	3537	3370	...
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	14.2	17.5
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	24.2	26.9
Exports (USD)*	% yoy cum.	2.6	1.0	-4.7	-7.1	-6.2	-5.2	-7.7	-6.5	-9.0	-8.8	-7.6	-12.2	-10.0	-6.8	-8.3	-6.4	-6.7	-6.8	-8.2	...
Imports (USD)*	% yoy cum.	7.6	5.6	-0.8	-8.3	-4.1	-3.4	-14.7	-19	-6.0	-5.7	-5.8	-6.7	-13.6	-16.1	-19.9	-17.3	-17.3	-19.5	-22.4	...
Merchandise trade balance	USD bn cum.	-14.8	-20.5	-4.0	-7.1	-14.2	-19.6	-1.9	-0.6	-16.6	-18.0	-19.6	-0.8	-1.5	-1.9	-2.0	-2.2	-2.5	-2.7	-3.0	...
Current account**	USD bn cum.	-10.0	-14.4	-3.1	-5.5	-11.4	-16.4	-1.3	-0.6	-13.4	-14.5	-16.1	-0.4	-0.8	-1.3	-1.2	-1.5	-1.9	-2.3	-2.7	...
Gross international reserves	USD bn eop	29.3	24.5	24.7	23.2	21.6	20.4	14.2	16.1	20.6	18.8	20.4	17.8	15.5	15.1	14.2	17.9	17.1	16.1	15.9	16.2
Monetary Base	% yoy eop	5.8	6.4	9.9	13.4	14.8	20.3	28.5	25.1	17.3	20.9	20.3	17.0	21.0	28.5	26.8	26.7	27.3	25.1	20.4	...
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	16.1	16.8	...
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	12.98	13.01
Exchange rate (official)	USD aop	7.99	7.99	7.99	7.99	7.99	7.99	8.9	12.71	7.99	7.99	7.99	7.99	8.65	9.92	11.64	11.64	11.81	11.76	12.95	13.02
Exchange rate (official)	EUR aop	9.99	10.37	10.55	10.44	10.58	10.87	12.14	13.71	10.90	10.79	10.94	10.92	11.80	13.69	16.08	16.00	16.04	15.93	17.25	16.83

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		**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**	**Q2 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	313.0	372.7
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	-1.1	-4.6
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	5.7	-2.3
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	-9.1	6.9
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	-19.1	-18.5
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	-2.0	-7.4
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	-7.0	-11.3
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	6.0	-8.8
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	-6.8	-8.4
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	-3.9	-16.9
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	3.1	-9.1
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	-5.8	-6.1
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	-1.3	-0.6
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	-3.8	-2.1
Trade balance in goods	USD m	-1407	-1236	-697	-3597	-2851	-4580	-5224	-3867	-5577	-5215	-5833	-4045	-3053	-7232	-5268	-1949	-567
Trade balance in services	USD m	550	930	1115	1262	1514	2007	1312	1299	1362	1975	1084	822	893	1919	480	589	142
Current transfers	USD m	722	608	728	1039	878	988	803	683	805	777	711	533	589	480	547	232	472
Direct investment (FDI)	USD m	1282	923	1196	880	2422	2090	1623	1663	1091	2002	1871	821	472	1199	859	-713	-292
Portfolio investments (equity)	USD m	41	-20	-18	149	113	42	207	-3	74	83	339	705	579	664	-757	-239	-53
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	14.2	16.1
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
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
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	30.1
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
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
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
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
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	35.7	35.6
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	35.2	34.6
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
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	-5.5
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
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	-10.6
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	1.9	-1.9
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	8.8	8.2
Banking system																		
Monetary aggregate M0	% yoy cum	1.5	5.4	9.9	15.7	11.5	8.6	6.3	4.7	6.7	5.2	5.5	9.7	9.8	12.3	17.0	19.2	31.9
Monetary aggregate M2	% yoy cum	-5.4	6.9	13.2	25.5	22.0	16.0	14.4	11.2	9.0	10.7	13.1	16.0	17.9	19.2	17.5	17.7	13.4
Household deposits in national currency	% yoy cum	-8.5	7.1	20.1	43.3	26.0	16.7	12.3	14.4	16.4	16.3	16.3	19.1	26.5	33.4	38.0	7.9	-2.3
Household deposits in foreign currency	% yoy cum	4.7	22.8	21.5	19.7	21.0	15.7	13.4	12.4	10.8	17.0	21.8	17.0	14.7	8.4	0.9	19.8	10.2
Com. bank credits in national currency	% yoy cum	16.9	13.6	8.3	16.0	18.5	21.1	21.0	17.4	15.3	9.1	7.7	8.6	7.4	10.2	16.9	12.3	4.9
Com. bank credits in foreign currency	% yoy cum	-15.2	-13.7	-10.5	-2.1	0.9	-2.3	-4.2	-7.0	-10.8	-9.9	-7.3	-4.4	-0.4	0.8	2.8	36.4	38.5
Long-term com. bank credits	% yoy cum	-3.8	-3.9	-2.8	5.0	6.3	5.3	2.9	-2.9	-7.0	-8.0	-6.6	-5.6	-2.7	-0.5	2.9	26.3	24.4
Long-term com. bank credits	% of total	68.1	68.5	68.9	67.2	66.6	64.4	62.9	61.5	59.8	59.1	57.8	55.9	55.7	55.1	53.2	58.5	59.1
Average lending rate on national currency credits	% p.a.	19.8	17.3	15.0	13.1	13.5	14.1	18.4	15.5	15.6	19.5	20.8	16.2	15.3	15.3	16.5	18.4	17.5
Average lending rate on foreign currency credits	% p.a.	10.1	10.9	11.1	10.2	9.8	8.8	8.4	8.2	8.2	8.5	8.8	9.4	9.7	9.6	8.8	8.7	9.4

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

Contact information:

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

Head of the Board-Director

Igor Burakovsky
burakovsky@ier.kiev.ua

Chief Executive

Oksana Kuziakiv
kuziakiv@ier.kiev.ua

Academic Director

Veronika Movchan
movchan@ier.kiev.ua

Centre for Economic Studies

Oleksandra Betliy
betliy@ier.kiev.ua

Vitaliy Kravchuk
Kravchyk@ier.kiev.ua

Iryna Kosse
kosse@ier.kiev.ua

Kateryna Furmanets
furmanets@ier.kiev.ua

Artur Kovalchuk
kovalchuk@ier.kiev.ua

Dmytro Naumenko
naumenko@ier.kiev.ua

Mykola Ryzhenkov
ryzhenkov@ier.kiev.ua

Kostiantyn Kravchuk
k.kravchuk@ier.kiev.ua

Oleksa Stepaniuk
stepaniuk@ier.kiev.ua

Victor Grechyn
grechyn@ier.kiev.ua

Center for Contemporary Society Studies

Iryna Fedets
fedets@ier.kiev.ua

Hanna Opanasenko
opanasenko@ier.keiv.ua

Tetiana Oliinyk
oliinyk@ier.kiev.ua

German-Ukrainian Agricultural Policy Dialogue

Yuliya Ogarenko
ogarenko@ier.kiev.ua

Mariya Yaroshko
yaroshko@apd-ukraine.de