NATIONAL
BANK
OF UKRAINE

INFLATION REPORT

July 2017

PREFACE

The **Inflation Report** reflects the opinion of the National Bank of Ukraine (NBU) regarding the current and future economic state of Ukraine with a focus on inflationary developments that form the basis for monetary policy decision-making. The NBU publishes the Inflation Report quarterly in accordance with forecast frequency.

The publication of the macroeconomic forecast and its underlying assumptions aims at strengthening the transparency and predictability of the NBU's monetary policy. This should enhance society's confidence, an important prerequisite for anchoring inflation expectations and achieving price stability, which is the NBU's priority.

The Monetary Policy and Economic Analysis Department developed forecasts of inflation and other macroeconomic variables. The NBU Board approved the forecasts during a meeting devoted to monetary policy issues on 6 July 2017.[1] Macroeconomic projections, including inflation, comprise the principal input, but not the only one, the NBU Board considers in its decision-making. In addition to the projections of inflation and other macroeconomic variables, the NBU Board takes into account any new information appearing after the forecast has been developed. The assessment of risks to the outlook or relations between macroeconomic parameters may vary between members of the NBU Board.

The analysis in the Inflation Report is based on the macroeconomic data available at the date of its preparation; therefore, the time horizon of the analysis for some indicators may vary. This report used 30 June 2017 as the cut-off date for the data.

The Inflation Report is a translation of the original Report in Ukrainian. In case of any discrepancies between the original document and its translation to English, readers should consider the Ukrainian version of the Report as correct.

[1] NBU Board Decision No. 419-D as of 6 July 2017 *On the Approval of the Inflation Report.*

CONTENTS

TERMS AND ABBREVIATIONS

ATO	Anti-Terrorist Operation
NGCA	Non-government controlled area
Core CPI	Core consumer price index
GDP	Gross domestic product
GVA	Gross value added
SESU	State Employment Service of Ukraine
SSSU	State Statistics Service of Ukraine
SFSU	State Fiscal Service of Ukraine
EU	European Union
SSC	Social Security Contribution
ECB	European Central Bank
FTA	Free trade agreement
IKSO	Index of Key Sectors Output
IIF	Institute of International Finance
CPI	Consumer price index
PPI	Producer price index
Treasury	State Treasury Service of Ukraine
CMU	Cabinet of Ministers of Ukraine
BPM5 **BPM6**	IMF Balance of Payments Manual (5th edition) IMF Balance of Payments And International Investment Position Manual (6th edition)
IMF	International Monetary Fund
ILO	International Labor Organization
MY	Marketing year
MFU	Ministry of Finance of Ukraine
NBU	National Bank of Ukraine
NEER	Nominal effective exchange rate
REER	Real effective exchange rate
OECD	Organisation for Economic Co-operation and Development
OPEC	Organization of the Petroleum Exporting Countries
MTP	Main trading partner
VAT	Value added tax
FDI	Foreign direct investment
RF	Russian Federation
CIS	Commonwealth of Independent States
WTO	World Trade Organization
USA	United States of America
DGF	Deposit Guarantee Fund
FED	Federal Reserve System
CEE	Central and Eastern Europe
EFF	Extended Fund Facility
FAO	Food and Agriculture Organization
MSCI	Morgan Stanley Capital International Inc.
PMI	Purchasing Managers' Index
USDA	United States Department of Agriculture

m	million
bn	billion
UAH	Ukrainian hryvnia
USD	US dollar
RUB	Russian rouble
M0	cash outside banks
M3	money supply
pp	percentage points
bp	basis points
USD/bbl	US dollars per 1 barrel
USD/ton	US dollars per 1 ton
USD/EUR	US dollars per 1 euro
UAH/USD	Ukrainian hryvnia per 1 US dollar
RUB/USD	Russian roubles per 1 US dollar
yoy	in annual terms; year-on-year change
qoq	in quarter terms; quarter-on-quarter change
mom	in monthly terms; month-on-month change
sa	seasonally adjusted
pa	per annum

1. SUMMARY

Overall, inflation has been kept in check

In May 2017, **headline inflation** stood at 13.5% yoy, moderately decelerating from 15.1% yoy in March 2017. Actual inflation reading came in slightly above the NBU's projected path published in the Inflation Report (April 2017).

The deviation of inflation from the forecast was mainly attributed to a faster growth in raw food prices. An increase in global meat and dairy prices has stimulated Ukrainian exports of these products. In addition, a partial loss of crops caused by spring frosts and an increase in the supply of more expensive imported products have affected domestic fruit and vegetable prices. In the meantime, the annual growth of administered prices and tariffs have decelerated.

Fundamental inflation pressure remained subdued, as core inflation was virtually stable and lower than expected. Growth in prices within core inflation was reined in by aggregate demand still being below its potential level, prudent fiscal and monetary policies, and descending imported inflation. A significant improvement in inflation expectations, resulting inter alia from favorable FX market conditions, also helped to contain domestic price pressures.

In Q2 2017, hryvnia continued to strengthen with respect to US dollar, supported by growing external demand amid a pickup in economic activity in Ukraine's main trading partners (MTP) and high agricultural exports as well. Meanwhile, metallurgical exports remained robust, despite negative implications of the halted trade with non-government controlled area (NGCA) and the seizure of industrial enterprises there. This was mainly attributed to still benign global prices for Ukrainian main trading commodities, although overall price environment was less favorable than a quarter before. In particular, global steel and iron ore prices remained at a higher level than in the respective period last year, offsetting lower grain and sunflower oil prices.

As expected, consumer demand has strengthened, underpinned by higher growth in nominal and real disposable household income, a gradual improvement in consumer sentiment, and a revival of consumer lending. As expected, the doubling of the minimum wage in early 2017 and a wider coverage of households by the housing subsidy program boosted growth in household income. However, households continued to reduce their savings to support consumption. In addition, slow growth in other nominal household income (primarily from business and property), high utility tariffs, and higher unemployment weighed on consumer demand. A rise in the unemployment rate occurred in spite of growing labor demand, which signaled about persistent labor market mismatches.

Ukraine's **fiscal policy** was prudent in H1 2017. Expenditures for socially sensitive needs grew at a slower rate, while capital expenditures continued to rise rather fast. Fiscal revenues continued growing rapidly thanks to general economic factors, tax changes, and transfers of the National Bank of Ukraine's (NBU) profit for 2016. Funds of former president Yanukovych officials confiscated following court ruling were an additional reason of a rise in budget revenues. As a result, the consolidated budget generated record primary and overall surpluses in January-May 2017.

Headline inflation will continue to decline

The NBU left its inflation projections unchanged for 2017-2019 at 9.1%, 6.0%, and 5.0%, respectively. The inflation forecasts remain within the **target levels** (8% ± 2 pp for 2017, 6% ± 2 pp for 2018, and 5% ± 1 pp for 2019 and in future years) set in the Monetary Policy Guidelines for 2017 and the medium term.

Through the rest of 2017, annual inflation will remain rather volatile, as it was in the first half of the year. In Q3 2017, it will remain in double-digits but will return to single-digits in Q4 2017. An inflation forecast for 2017 was left unchanged due to counterbalancing factors. On one hand, raw food prices will grow faster than expected earlier (by 11.8% yoy) due to supply-side shocks. On the other hand, contribution of administrated prices is forecast to be lower. Thus, the forecast for growth in natural gas prices and utility rates was revised downwards given that the new calculated gas price based on import parity was not officially published (according to an interim tariff adjustment mechanism, for natural gas tariffs for households to be adjusted from 1 October in case of the deviation from cost recovery based on import parity pricing, the new calculated gas price must have been announced by 1 July). In addition, considering a more favorable than previously expected FX market conditions, the forecast of core inflation was revised downwards (to 6.1% at end-2017).

In 2018-2019, administered prices are still forecast to grow fastest among inflation components (over 10% per year), reflecting expected moderate growth in global energy prices and Ukraine's excise policy.

Fundamental inflationary pressures are forecast to remain subdued. Prudent monetary and fiscal policies will be key for further disinflation trend. They will ensure a manageable recovery of consumer demand, effectively anchor inflation expectations and mitigate unnecessary FX market volatility. Below-potential aggregate demand and low inflation in Ukraine's MTP countries will also contribute. In addition, high crop yields – the result of investment into agriculture – will help rein in food inflation over the mid-term.

In Q1 2017, economic growth was supported by a recovery of domestic demand but adversely affected by events in the east

In Q1 2017, **real GDP growth** decelerated to 2.5% yoy. As expected, the suspension of trade with NGCA and the seizure of companies there in the middle of the quarter weighed on economic growth. At the same time, the growth was supported by private consumption thanks to a resumption of growth in real household income and continued robust growth in investment. A drop in gross value added (GVA) in some sectors for which monthly output indicators are not available and which rely on budget financing (like education and healthcare) was the main contributor to lower rates of GDP growth compared with the NBU's estimates published in April's Inflation Report (3.0% yoy).

In Q2, the suspension of trade with NGCA continued to exact a toll on economic performance, particularly of industrial sector. The performance of the mining industry and metallurgy was in-line with the NBU's estimates for the impact of transport disruptions in the east of Ukraine. At the same time, the situation in the energy sector has proven worse-than-expected, although it was partly attributed to temporary factors (e.g., weather conditions). On the other hand, business expectations and household consumer confidence have continued to improve and capital expenditures of the consolidated budget have grown substantially. Overall, however, the Q2 2017 estimate for real GDP growth was reduced from the previous forecast (to 1.5% yoy).

Larger energy imports and the suspension of trade with NGCA (which has affected metallurgical exports) has prompted a widening of merchandise trade deficit. That also resulted in a current account deficit of USD 0.3 billion in April-May 2017. In the meantime, net financial account inflows increased to USD 1.6 billion, ensured by both the public and private sectors. The successful completion of the third review of the EFF program with the IMF allowed the government to receive the next tranche of macro-financial assistance from the European Commission. A decline in cash outside banks and an increase in trade credit resulted in corporate sector net inflows. As of the end of May 2017, international reserves grew to USD 17.6 billion (or 3.6 months of future imports) thanks to a surplus of the **overall balance of payments** (USD 1.3 billion) in April-May and the fourth IMF tranche (USD 1.0 billion).

Real GDP growth projections for 2017 were revised downwards

The economic growth will slow down to 1.6% yoy. The forecast revision was to factor in the worse economic performance in the first half of the year, particularly in services, and the downward adjustment of grain harvest estimates. Sectors most susceptible to the disruption of production ties with NGCA in the east of Ukraine – mining and metallurgy, energy, and transport – will continue to underperform.

In 2018 and 2019, real GDP growth is projected to accelerate to 3.2% yoy and 4.0% yoy, respectively. The growth will be supported by gradually easing fiscal and monetary policies that will stimulate consumer demand. Private consumption will remain the main driver of real GDP growth backed by solid increase in real wages and a rise in pension benefits planned for 2017 autumn, firming consumer confidence and a resumption of bank lending. In addition, the economy will benefit from improving investment climate. At the same time, higher production costs and the statistical effect of a high comparison base will serve to slow investment growth. Agriculture, mining, and transport will remain the main recipients of investment.

The **current account deficit** will remain close to 4% of GDP in 2017-2018 and decline to 3% of GDP in 2019. Exports is forecast to increase thanks to improving terms of trade, strengthening external demand amid forecast growth acceleration in Ukraine's MTPs and high agricultural harvests. However, the recovery of domestic private consumption and buoyant investment demand will stimulate imports.

The current account deficit will be fully covered by inflows to the financial account, which will enable further accumulation of international reserves. In 2017, a decline in FX cash outside banks will remain the main source of the financial account inflows. In addition, confiscated funds of former president officials, which will be primarily allocated to repay public debt, will also allow increasing international reserves. In 2018-2019, investment and debt capital inflows to the private sector are expected to recover amid better investment climate. Moreover, the government is expected to issue sovereign Eurobonds as access to external financial markets is forecast to improve. This will allow rolling over part of the sovereign debt, given that peak of repayments fall due in 2019.

The key underlying assumption of this forecast is further cooperation with the IMF. Financing under the EFF program will remain an important source of replenishing international reserves. Moreover, continued cooperation with the Fund facilitates access to financing from other international organizations, and serves as an indicator of progress in the country's structural reforms and, hence, its investment attractiveness. Along with the overall BoP surplus, the receipt of tranches under the EFF program will allow to increase **international reserves** to USD 20 billion (or 4 months of future imports) by the end of 2017 and to USD 27.1 billion (or 5.2 months of future imports) by the end of 2018. In 2019, high public debt payments will lead to a decline in international reserves to USD 25.7 billion (or 4.8 months of future imports).

Fiscal policy will ease, as indicated by an expected expansion of the structural deficit. The fiscal stimulus of aggregate demand will be delivered primarily through an increase in pension benefits planned for October 2017. Over the mid-term, a further easing of fiscal policy will be limited to the need to keep the public sector deficit in-line with Ukraine's obligations to the IMF (within 3% of

GDP). In its current form, the pension reform announced by the government will boost private consumption most, although less budget funds will be available to capital expenditures. The pension reform will have a minor effect on the overall balances of the consolidated budget and the public sector budget. Growing pension expenses will be largely offset by higher proceeds from single social security contribution, including due to de-shadowing of the labor market, fostered by stricter requirements to the minimum pension-qualifying period. Over the forecast horizon, the quasi-fiscal needs of the banking sector and the Deposit Guarantee Fund (DGF) will be moderate, while Naftogaz will require no budget financing. The primary consolidated budget surplus is expected to exceed 1% of GDP, given large debt service expenditures.

Further monetary policy easing is conditional on the mitigation of risks to achieve inflation targets

In Q2 2017, after pausing for half a year, the NBU resumed the easing cycle of its monetary policy. Over April-May, the NBU Board cut the **key policy rate** twice – by a total 150 bp to 12.5% per annum. The NBU rate decisions were swiftly transmitting into market hryvnia interest rates. The favorable situation on the FX market combined with reasonably balanced inflationary risks have allowed the NBU to relax administrative FX restrictions further. During April-May 2017, hryvnia deposits kept flowing to the banking system, especially households' deposits. At the same time, consumer lending has picked up; however **overall lending** activity remained sluggish amid still high credit risks and a heavy debt burden in the corporate sector.

In the meantime, on 6 July 2017 the NBU Board decided to keep its key policy rate unchanged. This decision was aimed at containing the likely impact of faster growth in raw food prices on inflation expectations and mitigating demand-pull pressures stemming from expected increase in pension benefits in October this year. Meanwhile, accounting for favorable FX market conditions the NBU Board decided to relax FX restrictions further. In particular, possibilities for early repayment of loans attracted from nonresidents were expanded.

An assessment of the medium-term risks to the inflation targets will define the course of monetary policy easing in H2 2017. The risks to the annual inflation projections are considered as symmetrical. On one hand, administered prices, especially natural gas prices, could grow faster this year (this, however, would lead to lower inflation pressures next year). In addition, the impact of raw food supply-side shocks on overall inflation developments this and next years could be higher than currently projected. On the other hand, global energy prices could come in below the NBU's baseline scenario, which would directly influence domestic consumer prices as well as indirectly through lower value of imports and the consequent response of the exchange rate.

Over the medium term, the pace at which the government will raise social standards, particularly pension benefits, and potential changes to the parameters of government program of household subsidies are among the main sources of uncertainty. In addition, the speed of taking measures by the private sector and the government to minimize losses from the suspension of trade with NGCA will remain a major domestic risk. Apart from that, the risk of a military escalation in the east of Ukraine remains considerable.

At the same time, there will be further uncertainty about the implementation of the macroeconomic policies and structural reforms required to maintain macro-financial stability, boost the economy's potential, and continue cooperation with the IMF. Ineffective reforms could push risk premiums up, which would adversely affect inflation and exchange rate expectations and increase inflationary pressures.

If these and other risks materialize over the forecast period, actual inflation could deviate from its targeted path, while a reassessment of the balance of risks could prompt the NBU to take action, as required.

2. CURRENT ECONOMIC SITUATION

2.1. EXTERNAL ENVIRONMENT

In Q1, economic growth in Ukraine's MTPs accelerated on increased domestic demand and international trade underpinned by a growth in global prices. Data from Q2 2017 show that the economies of some of Ukraine's MTPs continued trending positively despite weakness in commodity prices.

In Q2 2017, the global price environment as measured by the ECPI[2] deteriorated slightly compared with Q1. Despite a quarter-on-quarter drop in global ore prices, the overall external price environment remained generally favorable quarter-on-quarter thanks to higher steel and iron ore prices that offset lower prices for grains and sunflower oil.

In Q2 2017, crude oil prices fluctuated at around 50 USD/bbl. Prices were supported by the Algiers Accord and plans to prolong the deal until the end of March 2018. However, increased oil production by the US and some OPEC countries has enhanced the downward pressure on prices in the H2.

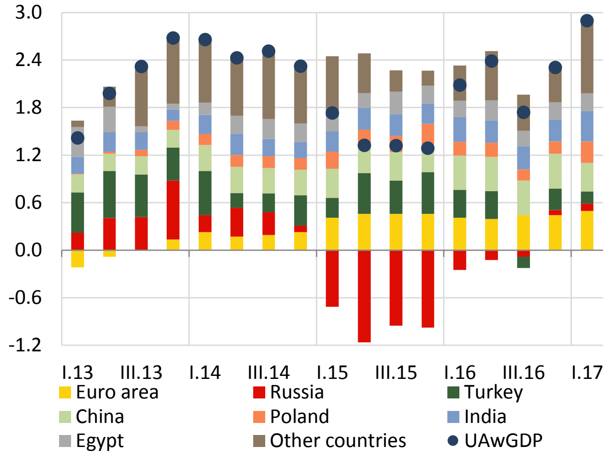
Global FX markets were influenced by expectations of positive economic activity in developed markets, growth in corporate profits, and signals of a slower normalization of the US Federal Reserve's (Fed) monetary policy. Moreover, political uncertainty in the US has caused the USD to weaken against a basket of major currencies, especially against the euro.

Amid broad optimism over an acceleration of the global economy, the environment for emerging market financial assets remained favorable, capital inflows continued, and those countries' currencies mostly strengthened against the USD.

In Q1 2017, the weighted average of annual economic growth rates of Ukraine's MTPs (as expressed by changes in the UAwGDP index) accelerated to its highest level in the last five years. Economic activity in the developed world grew steadily. At the same time, growth in emerging markets has accelerated, primarily due to Central and Eastern Europe (CEE). In particular:

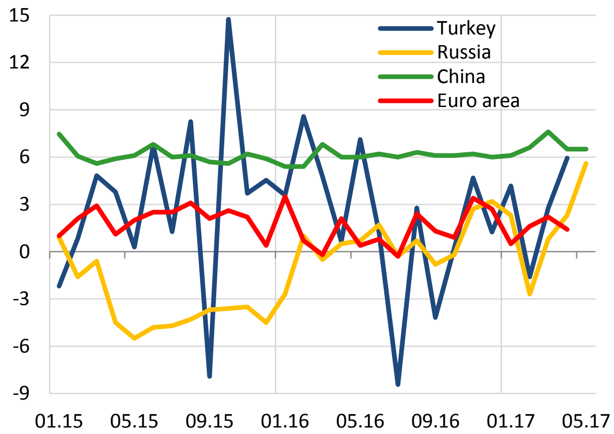
– Growth in US GDP remained steady quarter-on-quarter at 2% yoy. A pick-up in private investment by both residents and non-residents given expectations of fiscal stimulus countered a slowdown in the growth of consumption.
– Increased investment and exports supported economic growth in the euro area. However, annual real GDP growth rates remained practically level as imports accelerated and private consumption slowed.
– Growth in CIS economies has accelerated thanks to higher global commodity prices and stronger domestic demand from a decrease of inflation.

Contributions of Ukraine's MTP Countries to the Annual Change of UAwGDP, %



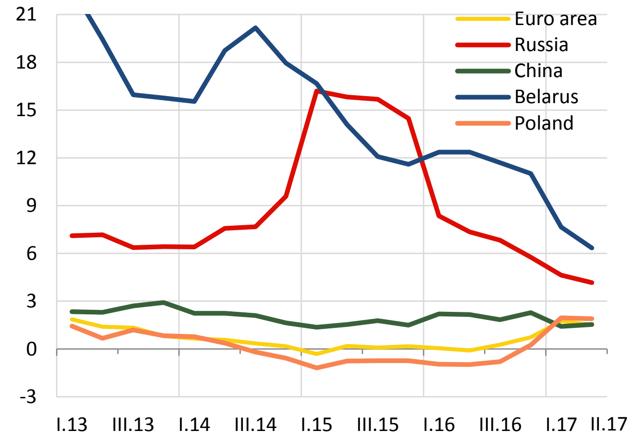
Source: NBU staff estimates (preliminary data)

Industrial Production in Selected Advanced and Emerging Economies, % yoy



Source: National Statistical Offices

Consumer Price Indices in Ukraine's MTP Countries, % yoy



QII.2017 – estimates
Source: NBU staff estimates (preliminary data)

[2]The ECPI is an index of changes in global prices for Ukrainian export commodities.

– In CEE countries, GDP growth accelerated, boosted by domestic demand on an increase in wages in response to a lower unemployment rate and a stabilization of inflation, as well as external demand from the EU.

– The growth rates of the Chinese economy continued accelerating – to 6.9% yoy in Q1 – on the back of state support and increased consumption.

– Private consumption and investment maintained economic growth in Turkey and Egypt. A depreciation of those countries' currencies also drove growth in exports.

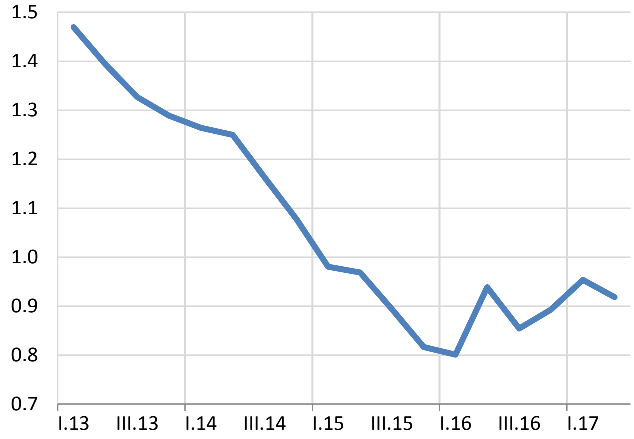
Since the start of Q2 2017, economic activity in many of Ukraine's MTPs has remained stable. In the US, faster growth of industrial production and further improvements in the labor market (the unemployment rate fell to a 16-year low of 4.3% in May) indicated an acceleration of economic growth. Improved consumer confidence and business expectations, particularly after the elections in France, supported economic activity in the EU. Large public and private investment helped stabilize China's industrial production growth at 6.5% after a major pick-up in March. China's economic recovery also boosted Asian countries and global goods markets. Meanwhile, year-on-year growth in raw materials prices boosted economic growth in CIS countries.

In Q2 2017, global prices for Ukrainian export goods remained generally favorable despite a slight decrease compared with Q1. In particular, prices for steel and iron ore were higher than in Q2 2016 (despite a substantial drop in ore prices in Q2 from Q1), which offset lower prices for grains and sunflower oil.

In Q2, prices for steel products and iron ore moved in opposite directions (except for the last days of June), although historically they were positively correlated. In Q2, average steel prices remained near two-year highs despite a significant dip at the start of the quarter. At the same time, iron ore prices have fallen almost 25% qoq, due to lower demand from China primarily.

China accounts for more than 65% of global iron ore imports[3]. China gradually reduced its iron ore imports due to: an increase in scrap metal in the production of some semi-finished steel products by local companies; record high iron ore inventories; a further expansion of Chinese investment in mining assets around the world, which allows China to increase its own raw material capacities (using domestic coal to produce iron ore during cast iron smelting, which is then used to produce steel) and increase access to infrastructure[4]. At the same time, global supplies continued to grow. According to BMI[5], the leading global producers – BHP Billiton, Fortescue Metals Group, and Rio Tinto – are actively increasing production, having reduced production costs to below 15 USD/ton. Iron ore prices recovered

External Commodity Price Index (ECPI, Dec.2004=1)

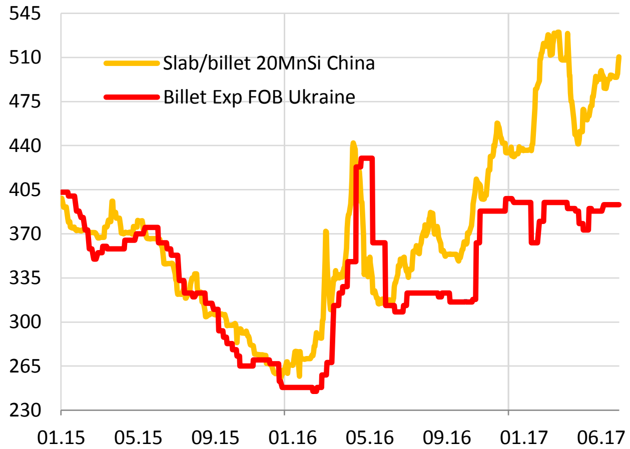


Source: NBU staff estimates

Semi-Finished Steel Price in China and Iron Ore Price imported by China from Australia, USD/MT

Source: Thomson Reuters Datastream

Semi-Finished Steel Prices in China and Ukraine, USD/MT



Source: Thomson Reuters Datastream

[3]According to World Steel Association – World Steel in Figures 2017. Read more in *Production of iron ore in the world and major determinants of prices* in the January 2017 Inflation Report, pages 11-12.

[4]In particular, the Chinese company Yancoal Australia Ltd (78% state-owned) agreed to purchase the largest Australian subsidiary of Rio Tinto Coal. The deal also includes the acquisition of 36.5% in Port Waratah Coal Services, which owns key supply channels.

[5]BMI Research Company is part of Fitch Group.

slightly only in late June, after the Chinese prime minister communicated an optimistic economic outlook.

However, prices for Chinese semi-finished steel products remained high against stable domestic demand and the continued push to cut excess capacities. Thanks to the implementation of infrastructure projects and investments in real estate development [6], high domestic demand caused a decline in China's exports of semi-finished steel products, although domestic steel production continued to grow. Output of crude steel increased 4.4% yoy in January-May 2017, while exports of semi-finished steel products from China, which accounted for nearly 36% of global steel exports in 2016, decreased 25.7% yoy over that period[7].

High demand for steel in the Middle East and the US additionally supported global prices for steel products in Q2. With a seasonal revival in the construction sector, companies in Egypt and Turkey resumed buying imported semi-finished steel products after a long break. High demand from the US has sent steel imports soaring (23.4% yoy in January-May according to the American Iron and Steel Institute).

However, demand for steel in the EU remained weak, while supply was high even despite anti-dumping duties on some types of Chinese steel and new investigations of supplies of galvanized steel from China and hot-rolled coils from Ukraine, Russia, Brazil etc. Apart from a domestic production increase (4.1% in January-May), the EU market received more supplies from India and Iran as those countries launched new production capacities.

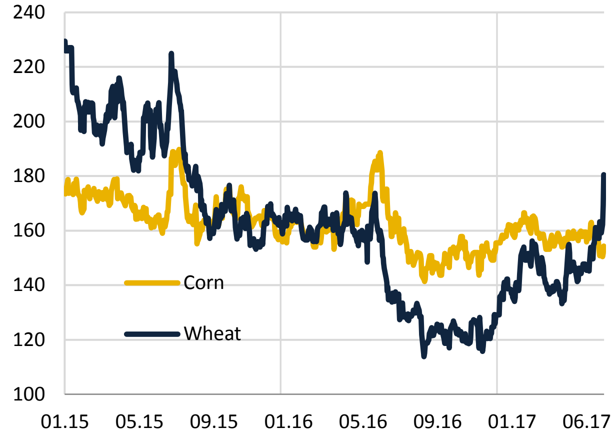
In Q2, global grain prices grew slightly qoq but remained much lower year-on-year. The prices were supported by:

– Reduced expectations for grain yields, especially wheat, due to unfavorable weather conditions in the US, certain European countries (particularly France, Spain, Bulgaria, Hungary, and Austria), and Australia
– Stricter requirements for wheat quality in several countries For example, in May Egypt's General Authority For Supply Commodities (GASC) raised its requirement for the protein content in wheat
– Higher demand for feed grain (primarily from Turkey, Egypt, Spain, Portugal, and Lebanon) and expectations of lower corn yields in the 2017/2018 marketing year (MY).

However, the price growth was held back by a sell-off of grain inventories from the 2016/2017 MY and expectations of new bumper crops in Brazil and Argentina thanks to favorable weather conditions.

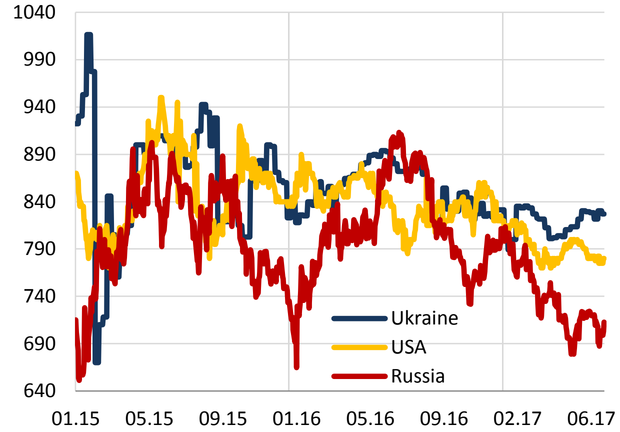
Global prices for sunflower oil and grain crops remained substantially lower than last year as a result of high yields, primarily in Ukraine. At the same time, as early as in May, prices for sunflower oil grew slightly owing to a seasonal production drop in Russia after scheduled repairs at food oil companies and the so-called *Brazil factor*, although supply

World Cereal Prices*, USD/MT



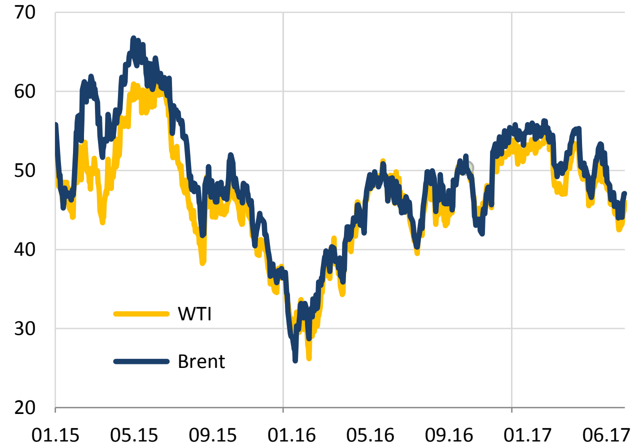
* Corn Yellow #2 Delivery USA Gulf
Wheat K C Hard (HRW) National
Source: Thomson Reuters Datastream

World Sunflower Oil Prices*, USD/MT



* Ukraine – Exwrks FOB Ukraine
USA – 1Mth United States
Russia – Russia Ex-WHS Blk Earth
Source: Thomson Reuters Datastream

Brent and WTI Crude Oil Prices, USD/bbl



Source: Thomson Reuters Datastream

[6] According to the National Bureau of Statistics of China, in January-May 2017, infrastructure investment grew 20.9% yoy and investment into real estate development grew 8.8% yoy. MarketsandMarkets estimate that the Chinese government will spend an additional USD 720 billion on infrastructure projects by the end of 2019.

[7] According to the National Bureau of Statistics of China and the General Administration of Customs of the People's Republic of China.

remained high. An increase in demand from India and Turkey was another price driver *(read more about the key factors of prices and demand for sunflower oil in the relevant box)*.

In Q2 2017, global oil prices fluctuated in a range of 50 +/-5 USD/bbl and decreased at the end of the quarter. The Algiers Accord struck between the main oil producing nations and an agreement to prolong the deal until the end of March 2018 supported prices. Seasonal growth in demand for oil products, particularly in the US and Saudi Arabia, was another factor.

However, in the second half of the quarter, prices mostly fell as a result of:

– Increased oil production in the US and Canada
– Further growth in oil production in Nigeria (6.7% in May to 1.51 million bbl/day) and Libya, which pushed production to a 3-year high (827,000 bbl/day).
– High commercial inventories of liquid fuel across the world, although they started to decline at the start of the year (according to the US Energy Information Administration (EIA), in May global commercial liquid fuel inventories in OECD countries exceeded the five-year average by 257 million barrels).

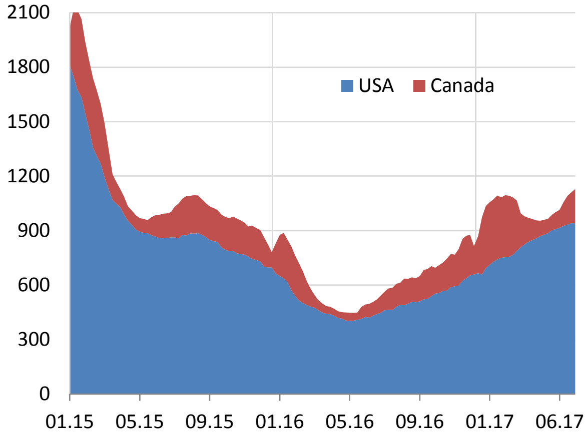
In Q2 2017, global financial markets remained generally favorable despite some temporary volatility. The S&P 500 Index grew on the back of positive corporate earnings, announcements by the US president of some facets of the proposed tax reform, messaging from the US Fed signaling a possible slowdown in the pace of interest rate hikes, and the positive results of stress tests of the 34 largest banks in the US.

The growth of stock market indices was held back by renewed geopolitical tensions between the US and other countries (notably China, Russia, and Syria), reduced expectations over the ability of President Trump to fulfill election promises (particularly related to tax reform), and increased spending on infrastructure projects.

These events influenced global financial markets, spurring a drop in the USD and a shift towards safer assets. An index of the USD relative to a basket of foreign currencies (DXY) declined 4.7% over the quarter (in particular, the US dollar fell to USD/EUR 1.14 at the end of the quarter) wiping out the USD's strength after the US presidential elections. As a result of increased demand for safer assets, yields on US treasury bonds decreased to a YTD low (2.14% as of 12 June 2017).

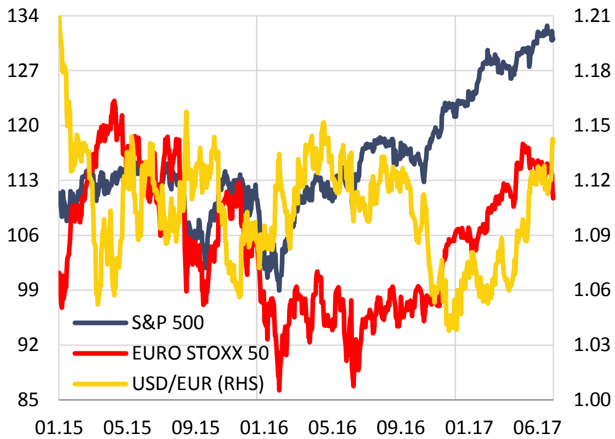
Growth in the EURO STOXX 50 Index starting in Q2 was driven by the positive election results in France, a temporary shift of capital flows from the US to Europe due to higher political risks in the US, and an acceleration of the euro area's Q1 2017 economic growth. At the same time, starting in the second half of the quarter, European indices corrected after reaching a two-year peak. Political instability on the back of parliamentary elections in Great Britain, the possibility of early elections in Italy, and uncertainty over

North America Rotary Rig Count



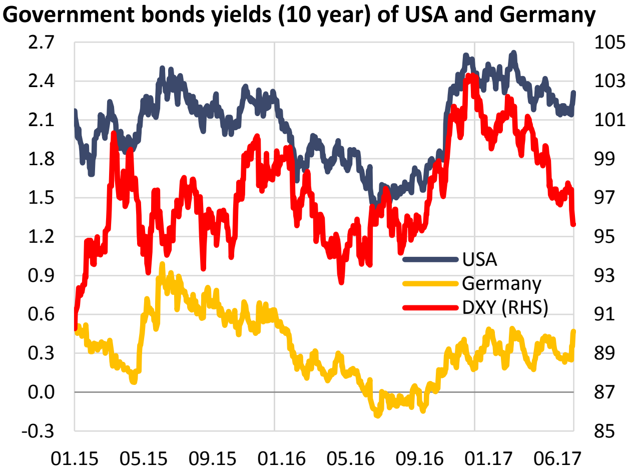
Source: Baker Hughes

World Stock Indices



Source: Thomson Reuters Datastream

Government bonds yields (10 year) of USA and Germany



Source: Thomson Reuters Datastream

international creditors reaching agreement on writing off Greece's debt all impacted European indices.

Under these conditions (both financial and macroeconomic), the monetary policy pursued by leading central banks met the expectations of market participants. In particular, in June the Fed increased its key federal funds rate by 25 bp to 1-1.25%, announced plans to reduce its balance sheet assets (which amounted to USD 4.5 trillion after its stimulus programs), and signaled another possible hike in its key rate by the end of 2017. In turn, the ECB and the Bank of Japan left their policy stance unchanged. By contrast, central banks across most emerging markets continued to cut interest rates as inflationary pressures have decreased (especially Russia, Chile, Brazil, Kazakhstan, and others).

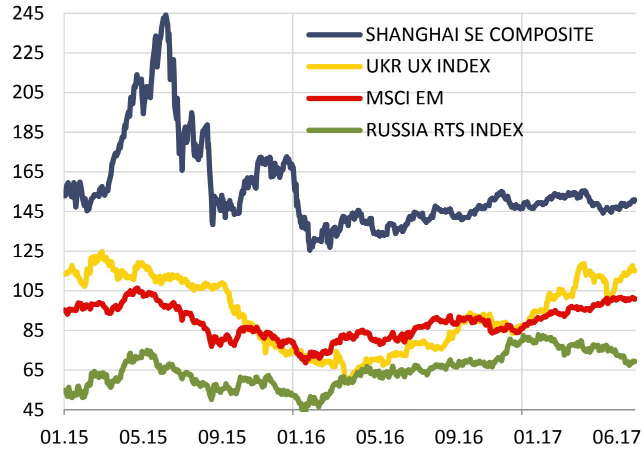
In Q2 2017, inflationary pressures in Ukraine's MTPs continued to decrease – the annual growth of the UAwCPI index[8] fell to a 15-year low. Inflation has decelerated both in developed countries and emerging markets. Despite the stimulus by leading central banks, a drop in energy prices has caused inflation to slow.

Although investors showed less interest in risky assets, according to the Institute of International Finance (IIF), capital inflows to emerging markets continued and averaged around USD 20 billion per month. The investment attractiveness of those countries grew as a result of:

– A substantial acceleration of economic growth in emerging markets (the IIF estimates growth accelerated to 6.8% qoq in Q1, the highest level since 2011)
– The completion of monetary reform in India
– President Trump's plans to remain a member of NAFTA, which reduced concerns over the US's trade protectionism.
– Expectations of growth in global commodity markets.

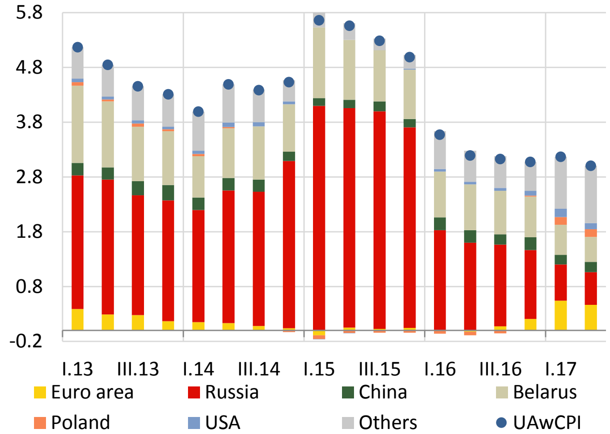
In Q2, the situation on global FX markets was uneven for emerging markets. The currencies of oil-producing emerging markets mostly depreciated. At the same time, CEE currencies continued strengthening substantially.

Emerging market stock indices, 01 Jan 2014=100



Source: Thomson Reuters Datastream

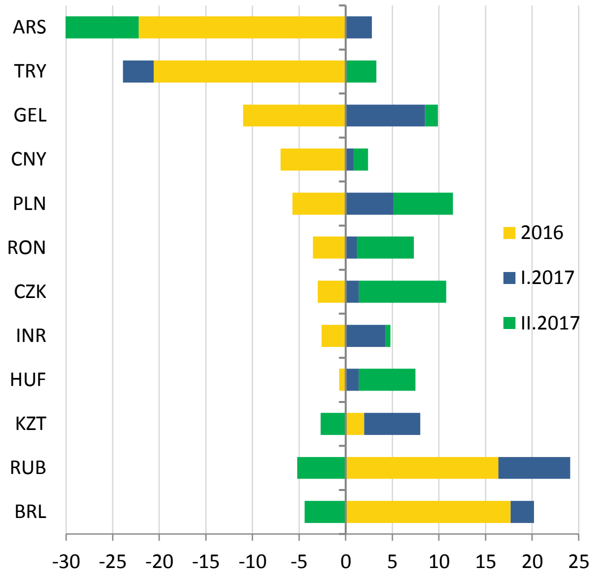
Contributions of Ukraine's MTP Countries to the Annual Change of UAwCPI, %



Q2.2017 – estimates

Source: NBU staff estimates (preliminary data)

Exchange Rates of Emerging Market Currencies versus US Dollar, % change, eop



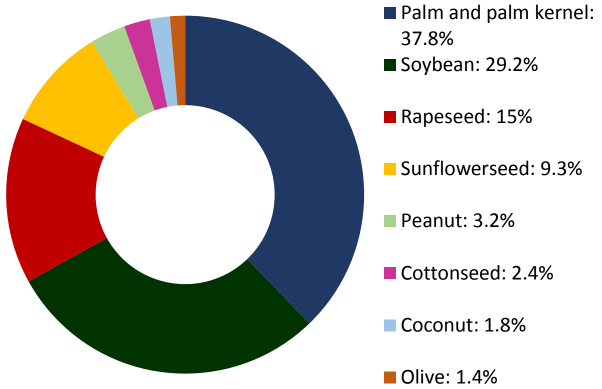
Source: Thomson Reuters Datastream

[8]The UAwCPI is an index of inflation in Ukraine's MTPs, weighted by the volume of Ukraine's goods and services imports from each country.

Box: Global Sunflower Oil Market Conditions

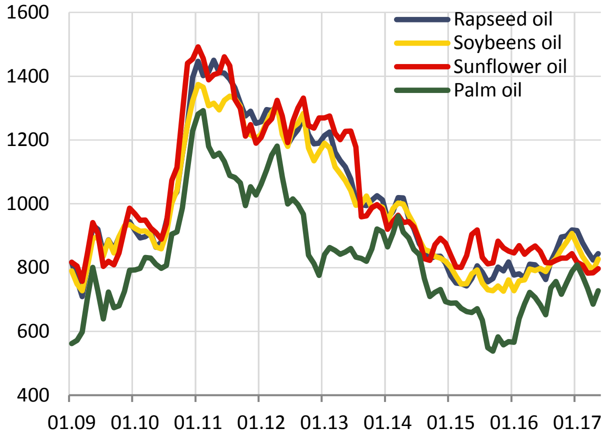
Globally, the seeds and fruit of more than 100 crops are used to produce vegetable oil. The most popular crops are soybean, sunflower, rape, and oil palm, which account for around 80% of the total output of oil crops. Sunflower oil is the fourth largest vegetable oil crop, with a preliminary global share of 9.3% in the 2016/2017 MY. Modern technology has prompted the consistent growth of global sunflower oil production in recent years to more than 17.3 million tons in the 2016/2017 MY.

Share of sunflower oil in the total production of vegetable oils



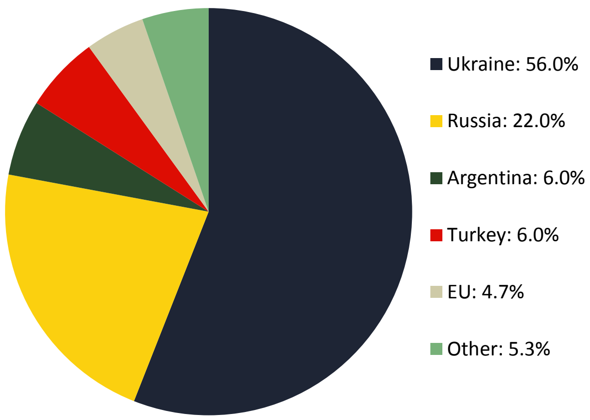
Source: Foreign Agricultural Service/USDA (2016/2017 MY)

Major Vegetable Oils Prices, USD/MT



Source: World bank

Major Exporting Countries of Sunflower Oil



Source: Foreign Agricultural Service/USDA (2016/2017 MY)

Sunflower oil prices are driven by:

– *Crop yields and supply.* Production indicators, the previous year's harvest, and expectations for the current yield all have a significant influence on prices. Their effect on prices is strongest when the actual figures of the largest exporting countries fail to meet the expectations. As a rule, sown areas, future crops, the time of harvesting, and carry-over stocks in the warehouses are factors. Starting in early 2017, prices have been pushed downwards by farmers and processing companies selling more sunflower seeds to draw down overloaded storage facilities[9].

– *increase/decrease in the supply and change of prices for substitute goods* (especially for palm and soybean oils, which are most widely used). For example, in 2017, the so-called *Brazil factor* emerged. In early June, the Brazilian agency Conab once again raised its estimate for Brazil's soybean output to a new record of 113.9 million tons, 19.4% higher than in the 2015/2016 MY. This has depressed soybean oil prices, which has fed into weakness in prices for other types of oil, including sunflower oil.

- *change in demand.* Global demand for agricultural products is growing steadily, especially in emerging markets due to rapid population growth and increasing incomes (also, because of the higher income elasticity of demand for food products). In addition, with the development of biotechnology, producers of bioethanol and biodiesel fuel have been increasing demand for oil crops over the last decade[10]. In the past, the production of this type of fuel grew materially during periods of high prices for traditional energy resources. Consumption patterns, especially interest in healthy nutrition, also influences demand. Asian countries, especially India and China, and Europe remain the world's main consumers of sunflower oil.

– *extraordinary events, mostly related to weather conditions.* For example, excessively warm weather during the vegetation period is favorable for insects, which could spoil future crops, while droughts could lead to fires. Prices are also influenced by more exotic factors – for example, El Niño[11], which creates drought in some countries and brings rainfall to others, both of which reduce crop yields. This natural phenomenon mainly influences the climates of Brazil, Argentina, Mexico, the US, and Australia. El Niño was the key factor in the drop in yields of soybeans and oil palm in late 2015 to early 2016, which caused prices to grow in the latter part of 2016.

Ukraine was and remains a leading producer and exporter of sunflower oil (33.2% and 56.0% respective shares in the 2016/2017 MY). Ukraine had a record sunflower harvest in the 2016/2017 MY, 21.9% higher than in the 2015/2016 MY. This

[9]According to the State Statistics Service of Ukraine, in May farmers and processing companies had 1.59 million tons of sunflower seed inventories (58% more than last year).

[10]Rapeseed oil, which is used to produce biodiesel in the EU, and soybean oil, which is used to produce bioethanol in the US, are credited as being the largest growth drivers.

[11]El Niño refers to fluctuations in water temperature in the equatorial Pacific Ocean, which have a major influence on the climate.

resulted in Ukraine growing sunflower oil production 14.5% and exports 13.3%[12]. The geography of Ukrainian sunflower oil exports[13] is broad (to more than 90 countries), but India (31.5%), China (13.7%), and the euro area (30.4%) are the main importers of Ukrainian oil.

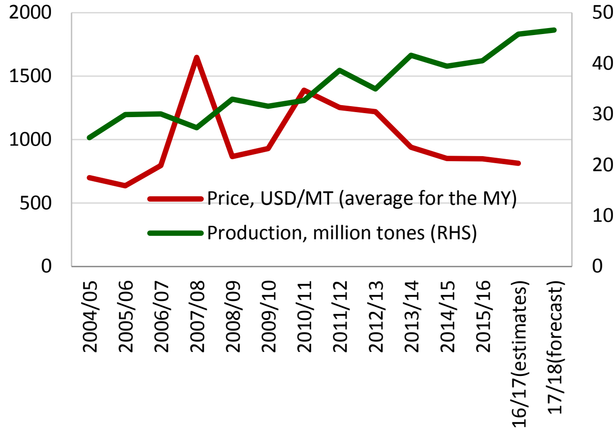
The USDA forecasts that sunflower oil production in Ukraine will continue growing in the 2017/2018 MY despite a reduction of the area sown with sunflower and its replacement with soybean. Accordingly, Ukraine's sunflower oil exports are expected to grow 2% to approximately 5.2 million tons.

In total, according to the USDA's forecast, global production of sunflower oil will grow 3% to 17.9 million tons (after a 12.4% increase in the 2016/2017 MY). That said, output volumes are expected to grow because of higher crop yields rather than on an expansion of areas sown with sunflower (last year, sunflower yields were 3% higher than the five-year average).

At the same time, global consumption is expected to increase 4% in the 2017/2018 MY to 16.8 million tons. With consumption set to grow faster than production, global carry-over stocks will be drawn down. However, they will still remain quite high.

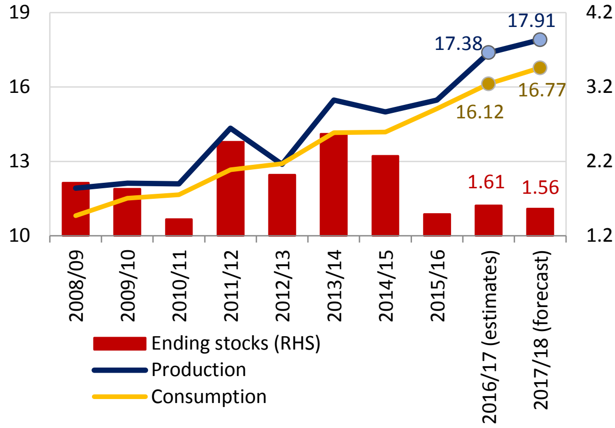
While the global output of sunflower oil grows, the production of palm and soybean oils will also increase (palm oil by 6.2% on the back of growth in Indonesia and Malaysia; soybean oil by 3.6% because of production growth in China). This will reduce sunflower oil's global share of vegetable oils to 9.1%. The excess supply of oil crops on the global market will keep sunflower oil prices relatively low.

Price and production of sunflower oil in the world



Source: Foreign Agricultural Service/USDA; NBU staff estimates based on World bank

World production, consumption and ending stocks of sunflower oil, million tones



Source: Foreign Agricultural Service/USDA, June 2017

12 According to the Foreign Agricultural Service/USDA, in the 2016/2017 MY.

13 According to the State Statistics Service of Ukraine, data for the 2016 calendar year.

2.2. DOMESTIC ECONOMY

2.2.1. INFLATION DEVELOPMENTS[14]

In May 2017, headline inflation came in at 13.5% yoy, down slightly as expected from 15.1% in March 2017. Inflation came in just above the NBU's projection as published in the April 2017 Inflation Report.

Growth in raw food prices continued to accelerate, which was the main reason for above-forecast inflation rate. Global prices for meat and dairy products have boosted Ukrainian exports. A partial loss of crops due to spring frosts and an increase in the supply of more expensive imported products have affected domestic fruit and vegetable prices. At the same time, the annual growth rates of administered prices and tariffs and fuel prices decreased against a high comparison base.

Underlying inflationary pressure remained moderate – core inflation was practically unchanged and below the forecasted level. Core inflation was held back by consumer demand, which still remains below its potential, as well as by the government's prudent fiscal and monetary policies, and a decrease in imported inflation. Inflation expectations improved significantly owing to favorable FX market conditions and other factors, which helped reduce pressure on prices.

Core Inflation

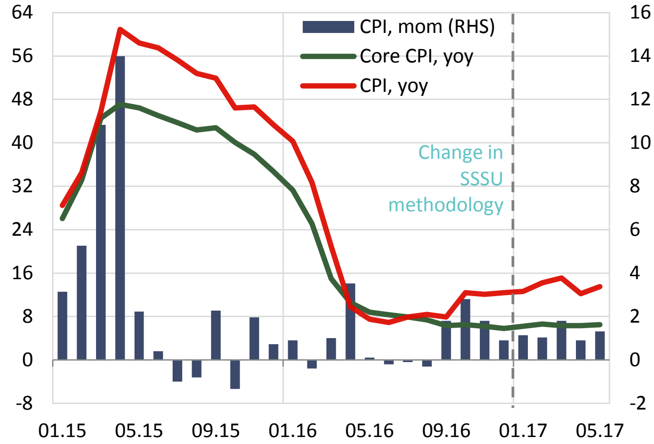
Core inflation was nearly unchanged at 6.5% yoy in May (6.3% yoy in March), although the secondary effects of the increase in raw food prices grew stronger as expected and higher costs (including wages) continued impacting prices.

Growth in prices for processed foods accelerated to 8.1% yoy in May. This was mostly driven by faster growth in prices for meat (20.9% yoy) on lower animal breeding activity, large export volumes, and higher global prices. In addition, price growth accelerated for bread, bakery products, and farinaceous products as production costs increased.

The growth of prices for services that are part of core inflation sped up to 10.7% yoy as production costs have increased. In May, the growth of dwelling maintenance tariffs accelerated, as did prices for recreation, restaurants, hotels, and other services. At the same time, a gradual increase of demand for services also contributed to the growth. A broader slate of services in the travel sector drove growth in prices for those services to 1.7% yoy after a 5.7% yoy drop in March.

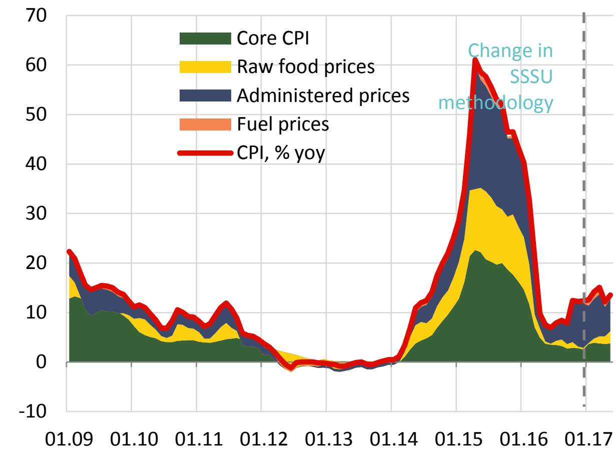
According to a Q2 survey of business expectations, companies are gradually adapting to higher labor costs. Compared with Q1, companies have cut their expectations for growth in prices for their products/services for the

Inflation Indicators, %



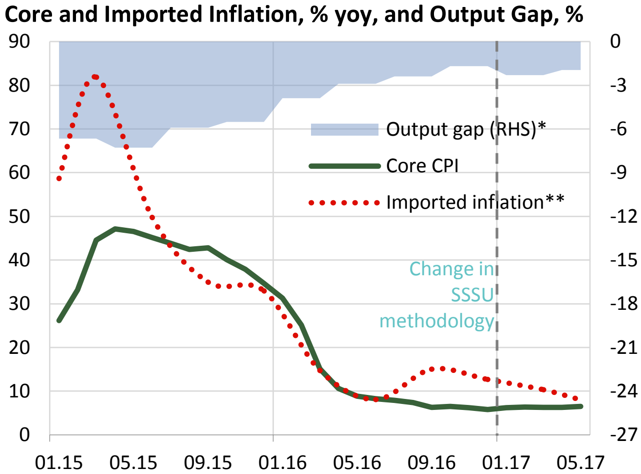
Source: SSSU

Contributions to Annual Inflation, pp



Source: SSSU, NBU staff estimates

Core and Imported Inflation, % yoy, and Output Gap, %



*GDP gap in Q2 2017 is calculated on the basis of GDP estimate
** Imported inflation is calculated as a quarterly change of UAwCPI, the indicator of consumer inflation in the countries - MTP, adjusted for the change of Hryvnia NEER *(for more information see Inflation Report April 2016, p. 9)*

Source: State Statistics Service of Ukraine, NBU staff estimates

[14] Prices for items in the basket of goods as defined by the National Bank of Ukraine (NBU) are based on data from the State Statistics Service of Ukraine (SSSU) and have been updated in-line with the new method for calculating their weightings.

following 12 months[15], including because of a lower impact of labor costs on initial prices[16].

Moreover, with favorable FX market conditions and slower inflation in Ukraine's main trading partners (MTPs), the annual growth rates of prices for clothing and footwear, home textiles, and household appliances continued to decline, while prices for other goods (including laptops, mobile phones, and some personal care products) remained lower on a year-on-year basis. Those results are generally in-line with the NBU's estimates for the pass-through effect of the changes in the nominal effective exchange rate (NEER) to inflation[17].

Owing to favorable FX market conditions, expectations for inflation in the following 12 months have fallen across all groups of respondents. This shift also restrained further growth in underlying inflationary pressure. Since the implementation of inflation targeting and the NBU's success in meeting the target in 2016, inflation expectations have been declining gradually but steadily. The expectations of financial analysts have fallen at the fastest pace; their outlook has neared the NBU's projected path of inflation, which sees inflation falling into the target range of 8% ± 2 pp as of the end of 2017. The expectations of households and corporates are on the decline as well. This was especially evident in Q2 2017. Studies[18] show that inflation expectations in Ukraine depend strongly not only on current inflation, but also on changes in the UAH/USD FX rate. Aside from the FX factor, the government's announced intent to not raise gas prices for households this autumn also contributed to the steep decline in inflation expectations in Q2.

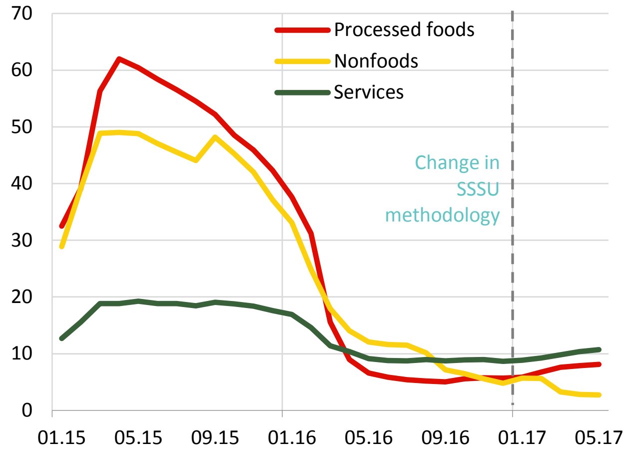
Alternative core inflation indicators also signaled a moderate increase in underlying inflationary pressure[19]. By all calculation methods, core inflation remains well below last year's headline inflation and the corresponding core inflation.

Non-Core Inflation

Non-core inflation has decelerated to 20.7% yoy in May (22.8% yoy in March). The slowdown was expected and was primarily due to the weaker effect of a high comparison base for a number of administered prices and tariffs, as well as fuel prices.

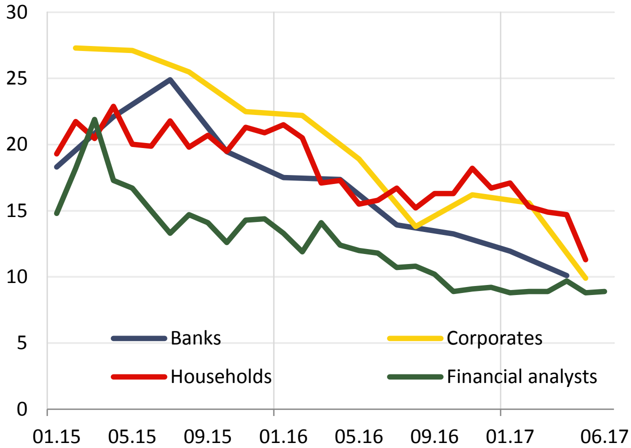
Growth in administered prices decelerated to 28.1% in May from 39.3% yoy in March. The slowdown came about as annual inflation stopped being influenced by the substantial increase in natural gas tariffs in April 2016, which created a high comparison base in early 2017. In addition, despite another increase in excise taxes for alcoholic drinks from 1 April, growth in prices for these products slowed to 16.7% yoy. This is partly attributed to agreements on ethyl

Main Components of Core CPI, % yoy



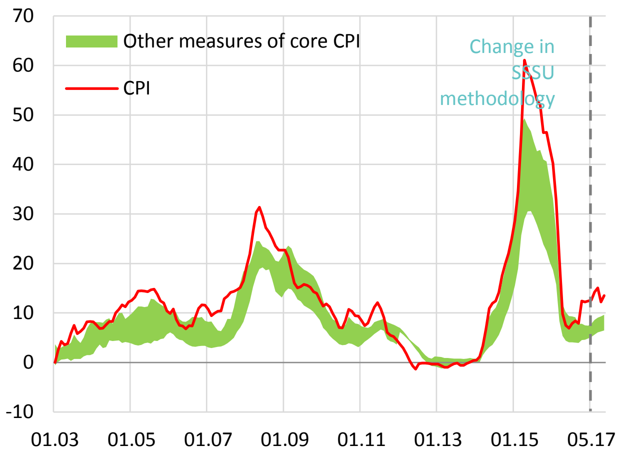
Source: SSSU, NBU staff estimates

Inflation Expectations for the Next 12 Months, %



Source: NBU, GfK Ukraine

Main Inflation Trend, %



* Green field – a range of core inflation indices
Source: NBU staff estimates

[15] In Q2, expectations for prices for companies' products/services for the following 12 months (the difference between responses of "prices will increase" and "prices will decrease") declined 10.8 pp qoq to 58.8%.
[16] In Q2, the share of businesses reporting that labor costs have an impact on the change in initial prices decreased 2.4 pp qoq to 48.6%.
[17] Read more in the October 2016 Inflation Report (pages 17-18).
[18] Read more: O. Coibion and Y. Gorodnichenko (2015).
[19] Read more in the January 2017 Inflation Report (pages 20-21).

alcohol prices between producers of spirits and alcoholic drinks. In addition, growth in prices for air travel and pre-school education decelerated as well.

At the same time, an increase in other components of administered prices hampered their overall deceleration. Tariffs for cold water supply and sewage collection increased starting 12 May. Moreover, in April-May postal rates grew rapidly (66.8% yoy) after PJSC Ukrposhta and other private postal companies raised rates. In addition, as in previous months, administrated prices were impacted by an increase in passenger transport fares owing to an increase in input costs and by faster growth in prices for tobacco products (40.8% yoy) on the back of distribution issues.

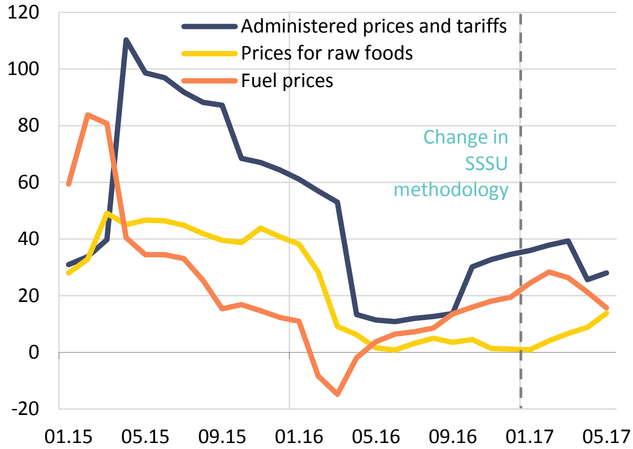
The rate of fuel price growth slowed to 15.7% yoy. Gasoline price growth slowed against a high comparison base (global oil prices increased sharply last year, but since the start of 2017 they have fluctuated in a narrow range with a slight decline). Meanwhile, prices for liquefied gas did not benefit from the base effect, which – coupled with Russian supply problems in April-May – led price growth to accelerate.

For several reasons, the decrease in global oil prices in April-May has not influenced domestic fuel prices yet despite favorable FX market conditions. First, there is a lag of approximately one month before oil product costs feed into fuel prices. In addition, end-of-month figures are often taken into account when determining price trends, whereas most fuel prices are registered throughout an entire reporting month. Therefore, comparing average monthly prices would be more correct. Second, the cost of oil products account for only 43% of the fuel price. Taxes, including excise taxes (calculated in euro according to the law), account for another 40%. Third, the NBU estimates that, in order to remain competitive, fuel sellers slightly reduced their markup early this year after fuel production costs rose. However, starting in April, they raised margins again in an effort to recoup previous losses. On balance, a small decline in fuel prices is expected in June-July.

As expected, growth in raw food prices continued to accelerate, reaching 13.8% yoy in May (from 6.7% yoy in March). This was driven by a low comparison base and a revival of consumer demand for food products in response to an increase of household incomes, as expected by the NBU. However, growth rates came in above the projected levels. First of all, prices for meat and milk grew faster in year-on-year terms on the back of higher global prices and large export volumes.

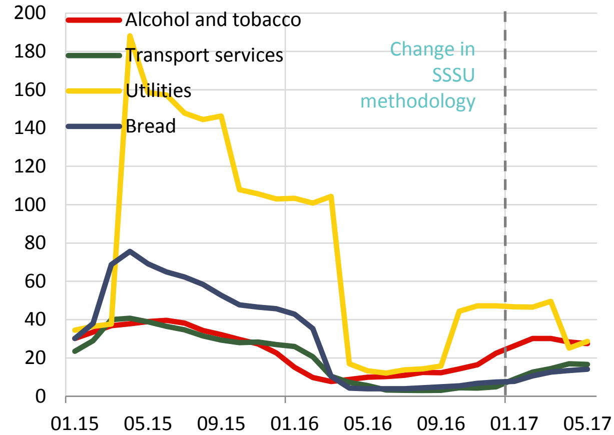
Expectations for a partial loss of the harvest due to unfavorable weather conditions also influenced raw food prices. Growth in prices accelerated again for fruits (12.7% yoy), while prices for vegetables resumed their growth (9.8% yoy) on lower domestic supplies, particularly owing to frosts in April-May. In addition, the SSSU's new approach to recording prices for the seasonal nature of fruits and vegetables helped accelerate price growth. Under the old methodology, prices for products from the previous harvest were registered alongside newly harvested items.

Main Components of Non-Core CPI, % yoy



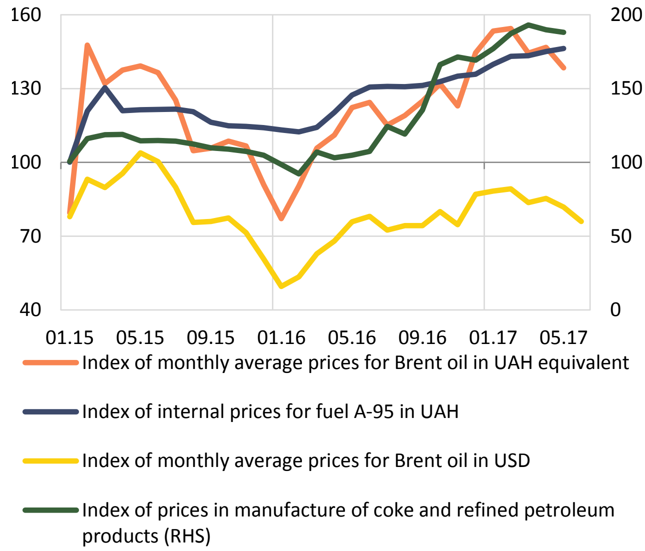
Source: SSSU, NBU staff estimates

Administered Prices and Utility Tariffs, % yoy



Source: SSSU

Price Indexes for Fuel and Oil (12.2014 = 100)



Source: SSSU, Thomson Reuters Datastream

Under the new methodology, prices for goods from the previous harvest are no longer reported once new harvest products enter the market. Greenhouse and field-grown vegetables are treated similarly. These changes will modify the seasonality of fruit and vegetable prices; they will grow materially in the months when new produce enters the market (particularly in May-June). At the same time, this effect should be neutralized during the year as regular harvest goods replace early products.

Egg prices stood out among raw food items, having decreased 10.4% yoy in May 2017 as partial restrictions on poultry exports were maintained.

Producer Price Index

In April-May 2017, the growth of the producer price index slowed substantially to 27.1% yoy from 38.3% yoy in March. This was primarily driven by price trends on global commodity and raw material markets, as local firms were largely export-oriented.

The decrease of global iron ore prices caused a significant deceleration of annual metal ore prices (to 35.9% in May from 142.6% in March), while a slight decrease in global oil prices drove a sharp slowdown of price growth in crude oil and natural gas production (to 12.0% yoy in May from 88.3% in March). This drove price growth in the mining industry down to 32.4% yoy from 94.7% yoy in March.

These trends were also reflected along the production chain: price growth slowed in metallurgy (to 28.9% yoy from 54.0% yoy in March), as well as in coke and refined products production (to 79.5% yoy from 80.6% yoy in March).

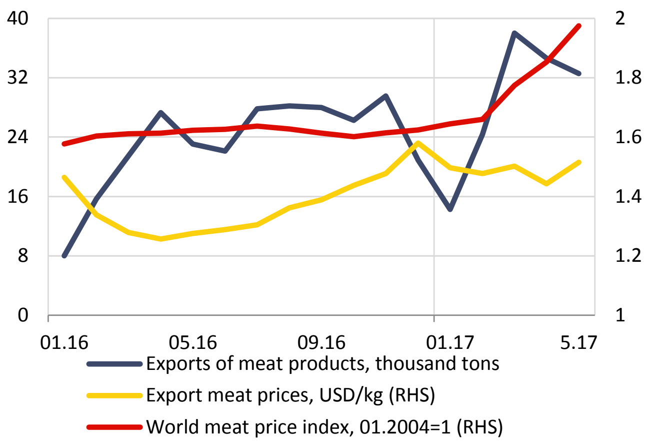
The increase in prices for the supply of electricity, gas, steam, and air conditioning decelerated to 37.9% yoy in May (from 42.6% yoy in March). That deceleration was driven by the full transition to market pricing for retail electricity rates for industrial consumers starting 1 May 2017[20] on the back of the stepped elimination of the cross-subsidization of household rates at the expense of other consumers. Another factor was an increase in the share of nuclear energy.

Price growth in the chemical industry remained practically unchanged at 12.4% yoy, which was primarily determined by demand, the global market environment, and production costs.

Prices grew faster in wood products and paper production as output dropped and production costs rose. Wages in that sector grew faster than the industrial sector average.

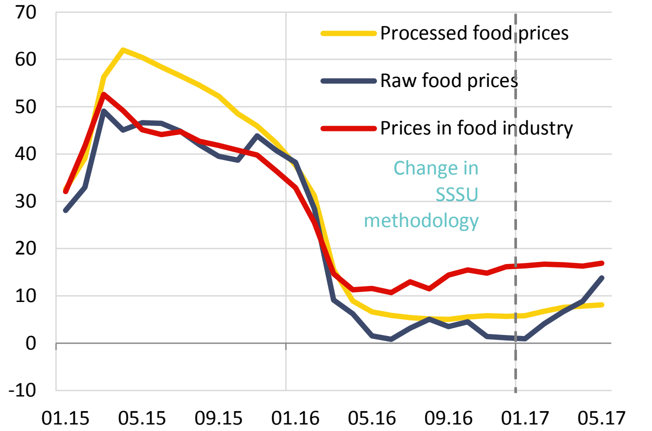
At the same time, according to the NBU, the increase in producer prices had a relatively limited impact on consumer prices[21], primarily due to supply and demand fluctuations. Only price changes in the production of food, drinks, and

Exports and Prices of Meat Products



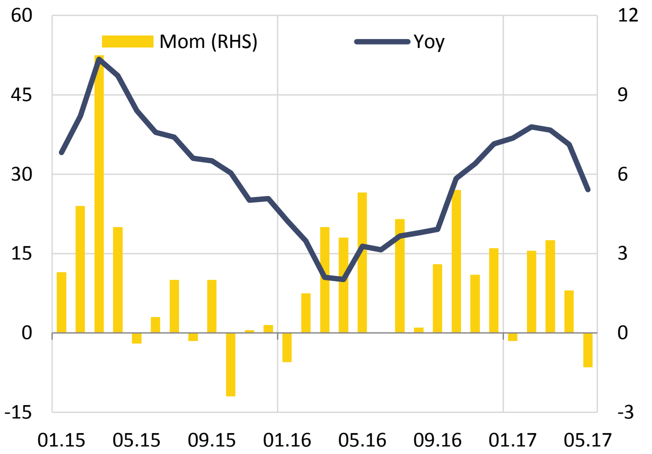
Source: SFS, FAO

Raw and Processed Food Prices and Prices in Food Industry, % yoy



Source: SSSU

Producer Price Index, %

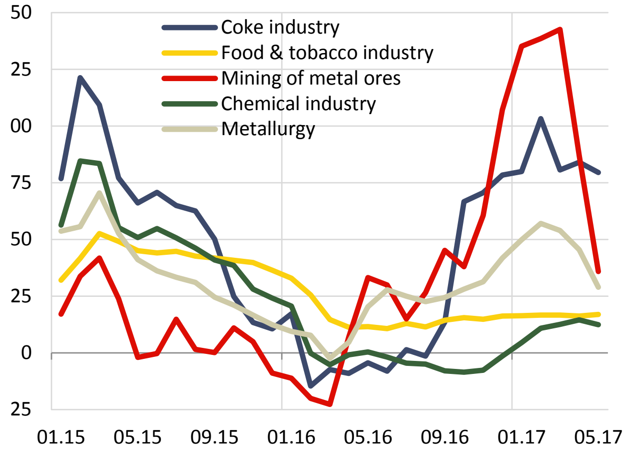


Source: SSSU

[20]Read more in the Decree by the National Commission for State Regulation of Energy and Public Utilities (NCSREPU) No.538 *On Market Pricing of Retail Electricity Tariffs for Each Consumer Class, Except Households, in Ukraine* of 24 April 2017.
[21] Read more about the impact of industrial inflation on consumer prices in the July 2016 Inflation Report, pages 16-17.

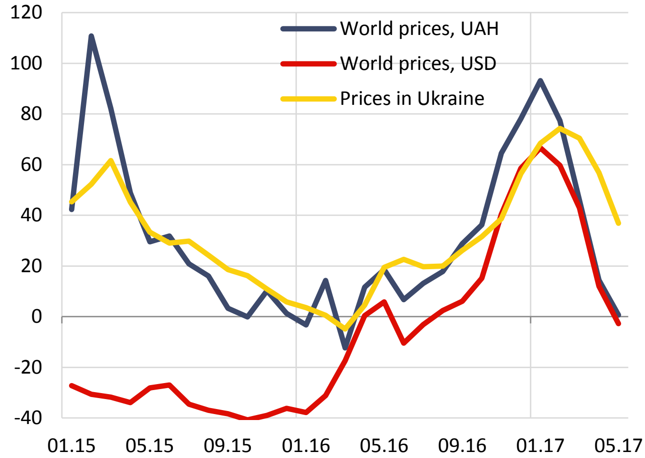
tobacco products are highly correlated to the food products and non-alcoholic drinks item in the consumer price index (CPI).

Producer Price Indexes in Select Industries, % yoy



Source: SSSU

Prices in the Mining and Metallurgical Production, % yoy



Source: SSSU, Thompson Reuters Datastream, NBU staff estimates

2.2.2. DEMAND AND OUTPUT

In Q1 2017, real GDP growth decelerated to 2.5% yoy as the seizure of companies in the non-government controlled areas (NGCA) and the disruption of production ties after the suspension of trade with the NGCA affected output. From the beginning of the year, the statistical reports traditionally excluded crop production that made a major contribution to GDP growth in Q4 2016 thanks to a record harvest.

The GDP growth rate underperformed the NBU's estimates as published in the April 2017 Inflation Report (3.0% yoy) as gross value added (GVA) decreased in some service sectors that do not report monthly output indicators and rely on budget financing (such as education and healthcare).

By final use categories, consumption contributed the most to real GDP growth in Q1. The NBU had expected consumption to take on an increased importance in GDP growth in 2017, especially as real household incomes resumed growth. As expected, investment again made a substantial positive contribution (including investment into machinery and equipment). The contribution of net exports remained negative, although to a lower degree than projected as the growth of imports slowed materially.

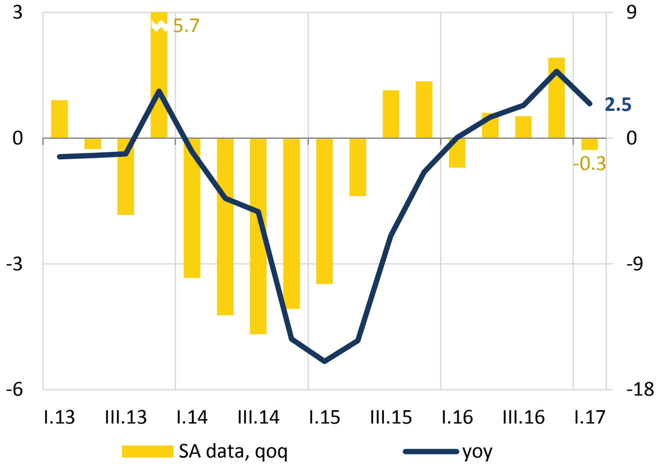
In Q2, the suspension of trade with the NGCA continued to affect economic activity, especially industrialperformance. The mining and metallurgy industries performed in-line with the NBU's estimates in terms of the impact of the transport disruptions in the east of Ukraine. However, the energy sector declined by more than expected, caused by temporary factors such as weather conditions and other factors. At the same time, business expectations and household consumer confidence have continued to improve and consolidated budget capital expenditures have grown substantially. Overall, the NBU has cut its estimate for real GDP growth in Q2 2017 from its previous forecast to 1.5% yoy.

Domestic Demand

In Q1 2017, growth in domestic consumption was a major contributor to real GDP growth. Household consumption grew 2.8% yoy and 2.2% qoq excluding seasonal factors. The revival of household demand was driven by higher real disposable incomes (+2.4% yoy), tapping into savings, a gradual improvement of consumer confidence, and a pick-up in consumer lending.

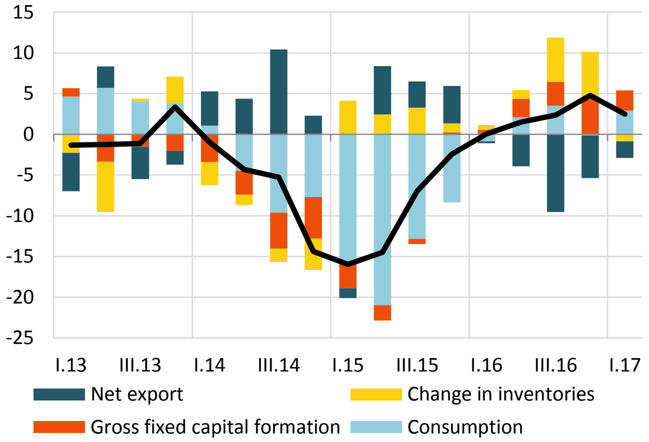
Consumption grew most for clothing and footwear, household goods, healthcare, and communication. The growth in consumption for these products is attributed to moderate annual price growth for corresponding goods and services compared with other items in the basket of goods. At the same time, households' real final consumption expenditures on public utilities decreased substantially (by almost 30% yoy) due primarily to the subsidy program's expanded coverage. An increase in the cost of those services, the introduction of energy saving initiatives, and

Real GDP Growth, %



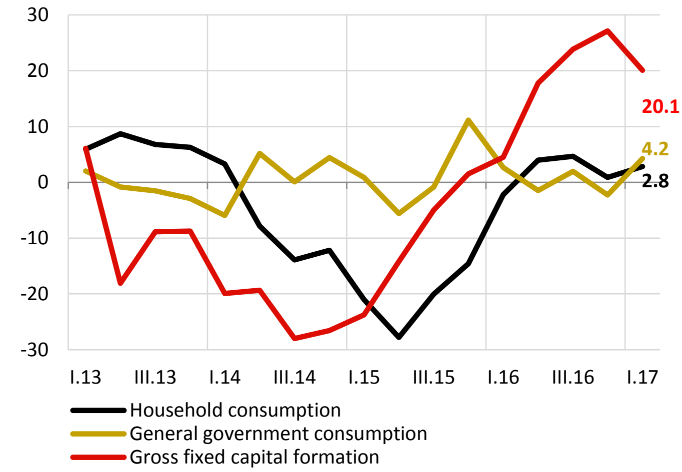
Source: SSSU

Contributions to Annual GDP Growth, pp



Source: SSSU, NBU staff estimates

Domestic Expenditure Components, % yoy



Source: SSSU

the early end of the heating season[22] thanks to warmer weather at the end of the quarter also contributed to the decline[23].

Significant growth in budget expenditures for household utility subsidies drove a sharp increase in individual consumer spending in the general government sector (by almost 10% yoy in real terms). As a result, general government consumption resumed growing as expected (4.2% yoy).

Growth in gross fixed capital formation slowed slightly (to 20.1% yoy) but remained high owing to substantial growth in investment into machinery and equipment (up to 44% yoy). An improvement of business outlook and corporate earnings encouraged a further revival of investment activity as investment demand was still financed mainly through equity.

Last year's high profitability in crop farming as well as the potential for continued yield growth boosted the renewal of agricultural companies' equipment, which increased their capital expenditures by almost 60% yoy. Transport companies have dramatically grown investment amounts. For example, Ukrzaliznytsia continued to update its freight railcar fleet and airlines also increased investment. The growth of investment in the industrial sector accelerated to 29% yoy, with chemical producers increasing investment 3.8 times. Among service sectors, healthcare showed the highest growth rate (2.5 times) owing to the need to upgrade materials and equipment.

During the reporting quarter, investment into residential construction started growing once again (9.9% yoy). At the same time, the growth of investment into non-residential constructionand intellectual property category slowed to 1.9% and 7.7% yoy, respectively.

In the agriculture sector, strong sales (including exports) and processing of crops have decreased inventories substantially. As a result, the contribution of inventories to the change in real GDP in Q1 was negative at -0.8 pp.

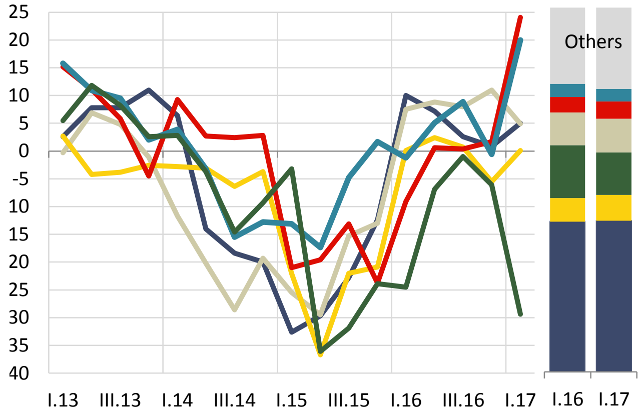
External Demand

As expected, net exports again contributed negatively in Q1 2017. However, they decreased by more than forecast, to 2.1 pp.

After resuming growth late last year, exports fell to a 0.4% yoy decline in Q1 as metal and metal ore exports decreased.

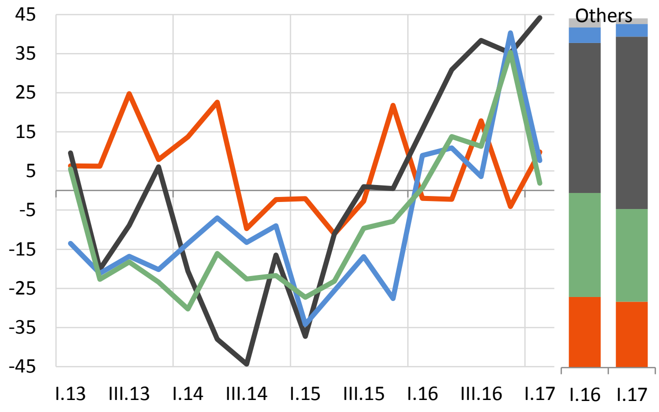
The growth of imports slowed substantially to 2.9% yoy, primarily on a slowdown in food imports and chemical products.

Final Consumption Expenditures of Households by Purpose, % y-o-y **Expenditure structure, %**



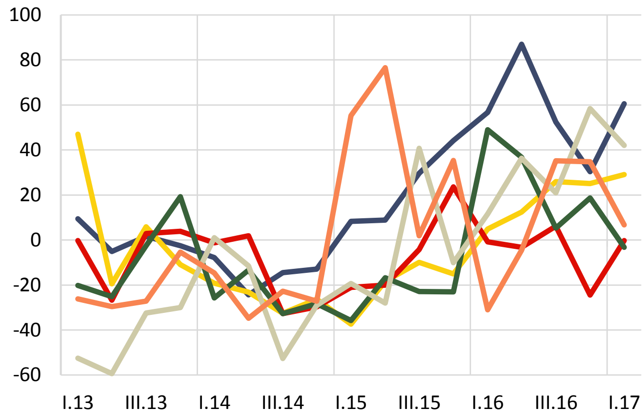
Source: SSSU, NBU staff estimates

Gross Fixed Capital Formation by Types of Non-financial Assets, % yoy **Structure of Fixed Capital Formation, %**



Source: SSSU, NBU staff estimates

Capital Investments by Sectors of the Economy, % yoy



Source: SSSU, NBU staff estimates

[22] Some households stopped using heating as early as in March.
[23] According to the Central Geophysical Observatory, Kyiv recorded an average air temperature of 6.2°C in March 2017 compared with 3.9°C in March 2016.

Box: Did Investment Demand Drive the Economy?

Investment demand began recovering rapidly in early 2016, which increased the pace of gross fixed capital formation. At the same time, demand was covered mainly by imports, which not necessarily supported the domestic economy, even though it created the potential for future economic growth.

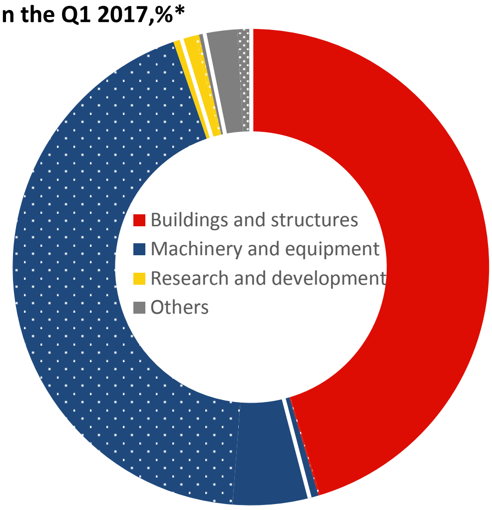
Investment in Q1 2017 flowed mainly to machinery and equipment (49% of total investment) and buildings and constructions (45%). For machinery, investment demand was largely covered by imports, although Ukrainian means of production were also in demand, which boosted their growth. Machinery output increased 2.0% yoy in 2016 and accelerated to 5.6% yoy in January-May 2017. Production grew fastest in industries that manufacture investment goods (industrial machinery and equipment, as well as transport vehicles, spare parts, and more). These sectors account for 8% of total industrial production.

Investment into construction was the main internal driver of economic growth since the investments went directly and in full to domestic producers. Along with the investment, construction activity picked up to 21% yoy in January-May 2017. Nearly one-third of the construction industry's intermediate consumption is imported. Nevertheless, the sector is the main consumer for many Ukrainian industries – according to the NBU, they hold a greater than 7% share of industrial production. As a result, that boosted the production of building materials, some chemical products, metal constructions, and the extraction of certain mineral resources. Activity increased in service sectors related to the construction industry – particularly in architecture, engineering, and real estate development. Employment levels improved in those sectors.

Among Ukraine's regions, the revival of construction activity varied in January-May 2017. With a significant share of total construction volume, growth of construction in Kyiv (20.8% yoy) was the main contributor (5.3 pp) to the increase of overall construction. At the same time, construction activity in many regions grew faster than in the capital: construction volumes doubled year-on-year in Kirovohrad and Zhytomyr oblasts, they grew more than 50% in Zaporizhia and Poltava oblasts and approximately 30% in Kharkiv, Odesa, and Kyiv oblasts. Residential construction did not grow in all oblasts. At the same time, engineering structures were built in many regions thanks to larger consolidated budget capex allowances for transportation infrastructure and municipal property, as well as for construction at power stations (to finance a shift to gas coal) and large capital expenditures by agricultural companies.

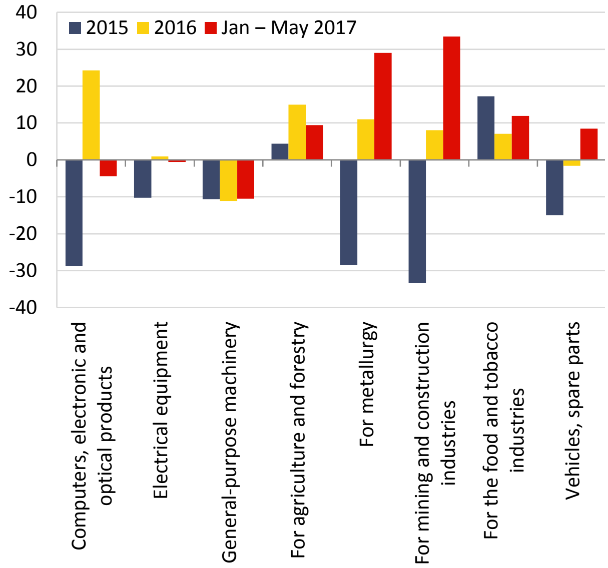
Thus, the increased investment demand supported the performance of many industries, the construction sector, and several service sectors. Although imports covered a substantial share of investment, especially into machinery and equipment, a revival of investment activity by local companies has created a base for an improvement in Ukraine's economic potential and for steady long-term growth.

The Structure of Investments by Type and Origin In the Q1 2017,%*



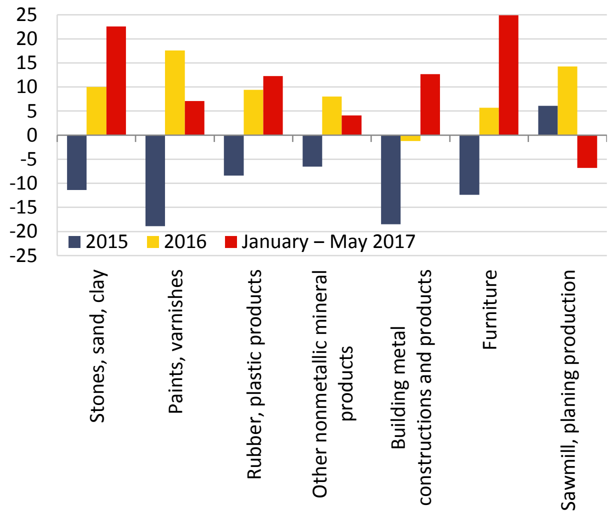
** The estimation of domestic and imported investment shares is based on the Input–Output Table for 2015. The texture fill reflects the share of imported investment*
Source: SSSU, NBU staff estimates

Output of Certain Machinery Products, % yoy



Source: SSSU

Output of Certain Construction Materials, % yoy



Source: SSSU

Output

A drop in the growth rate of Ukraine's real GDP in Q1 2017 was primarily driven by decreases in agriculture's and industry's GVA.

Agriculture was the major GDP contributor late last year thanks to strong crop farming performance, but the sector declined early this year (GVA declined 0.7% yoy), reflecting issues in the animal breeding sector.

The GVA of industry also decreased slightly (0.4% yoy) as the suspension of transport connections with the NGCA caused output in the mining and energy sectors to slump. Most notably, supplies of raw materials to thermal power plants and coking and metal companies experienced difficulties. Temporary extraordinary measures were introduced in the energy sector. In addition, a decrease in the metallurgy and warm weather in March caused a substantial reduction in electricity output.

The growth in construction's GVA accelerated in Q1 to 21.3% yoy, reflecting high investment demand in the economy. In the meantime, the pick-up in consumer demand has pushed the growth of GVA in the trade sector to 3.1% yoy. GVA growth rates in transport, warehousing, and postal and courier activities (reported as a single sector) also increased (to 4.7% yoy), which, among other factors, could be driven by larger natural gas transit and import volumes.

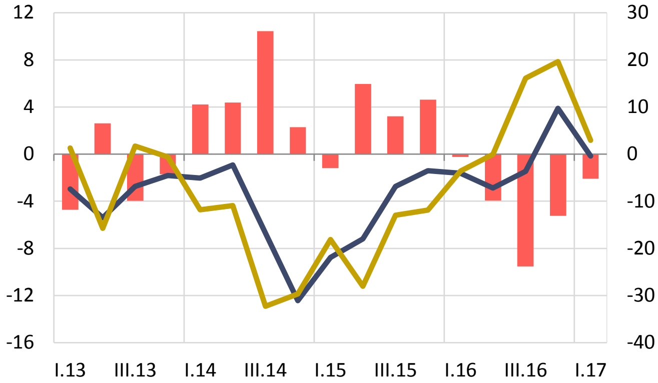
On the down side, the trend in the state-financed services sector deteriorated, unexpectedly: the GVA of the education sector fell further (to 2.8% yoy) and the GVA of healthcare declined (by 6.8% yoy). Factors could include limited budget spending (except for wages) and a decrease in the number of staff in those sectors. The GVA in finance and insurance declined slightly (0.3% yoy), related to a deterioration in banks' financials[24] and other factors. The substantial negative impact from those sectors GVA explains the underperformance of Q1 2017 real GDP versus the NBU's forecast published in the April 2017 Inflation Report.

Estimates for Q2 2017

The NBU expects economic growth will slow slightly to 1.5% yoy in Q2 2017. First, the adverse effect of the suspension of transport connections with the NGCA and the seizure of mining and metals companies have continued to affect industrial production and cargo transportation. The data available on the metals and mining sector supports the NBU's estimates for the economic impact of the suspension of trade with the NGCA.

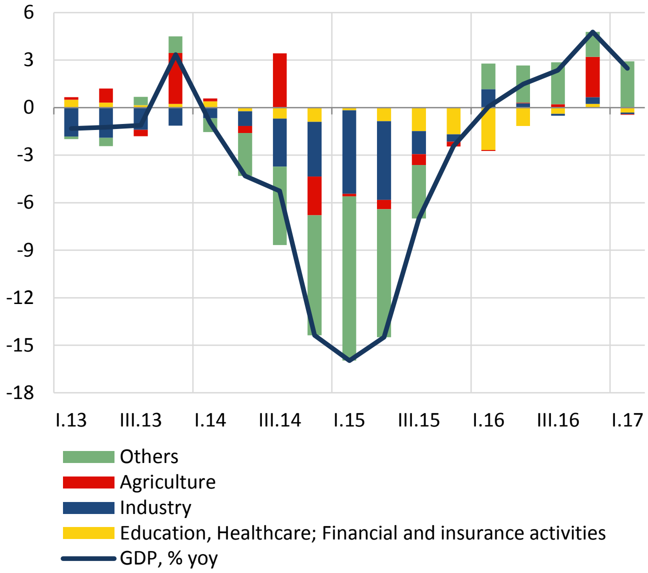
However, other factors restrained the activity of certain industries. In particular, the early end of the heating

Exports and Imports of Goods and Services, % yoy



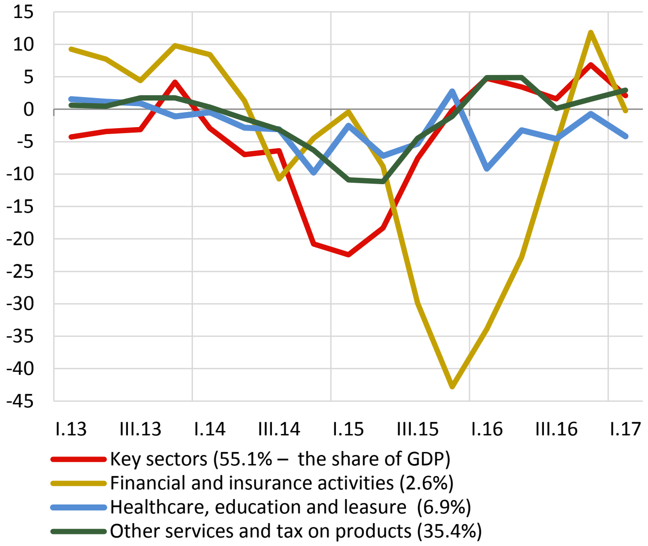
Source: SSSU, NBU staff estimates

Annual GDP Growth by Secroral Contriutions, pp



Source: SSSU, NBU staff estimates

GVA by the Groups of Sectors, % yoy



Source: SSSU, NBU staff estimates

[24] In Q1 2017, banks saw all revenue streams decrease with the exception of commission income. Nevertheless, bank earnings improved as provisioning for active operations decreased. However, provisions do not affect gross value added.

season[25] and the shutdown of anthracite-fired thermal power plants have led electricity output to fall.

At the same time, industries that are less exposed to the situation in the east of Ukraine have increased output. Among manufacturing industries, machinery output grew the fastest. Production of investment goods for specific sectors continued growing, including the production of railcars for the gradual renewal of Ukrzaliznytsia's rail rolling stock. Output of construction-related products grew rapidly in response to the increased demand from the construction industry. Food production continued growing, especially food oils, thanks to strong exports and large inventories of sunflower seeds after last year's bumper crop. Output of milk, flour, and meat grew moderately thanks to a pick-up in both domestic and external demand.

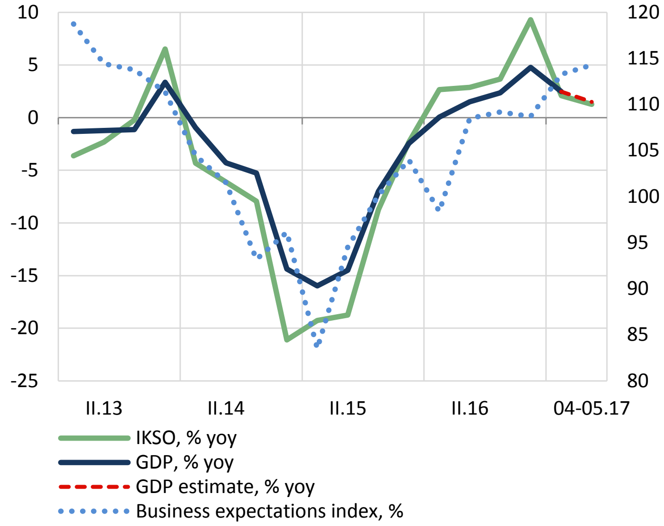
For most of the quarter, the agricultural production index was driven by animal production[26], where milk output fell as a result of a decrease in the cow population and pig breeding declined[27] as African swine fever spread. Poultry output (chicken farming and egg production) was also unstable and – despite growth in exports – the sector is still faced with export bans to some countries[28].

In Q2, business expectations continued improving, especially in the area of investment. According to the NBU, companies in the agricultural, manufacturing, energy, and transport sectors plan to make the largest investments. Moreover, consolidated budget capital expenditures increased substantially in Q2.

Correspondingly, construction activity continued to grow rapidly, even against a high comparison base. The construction of engineering structures revived as a large portion of customs duties were earmarked for road construction under the customs experiment. This shows that investment is continuing to play an important role in economic growth.

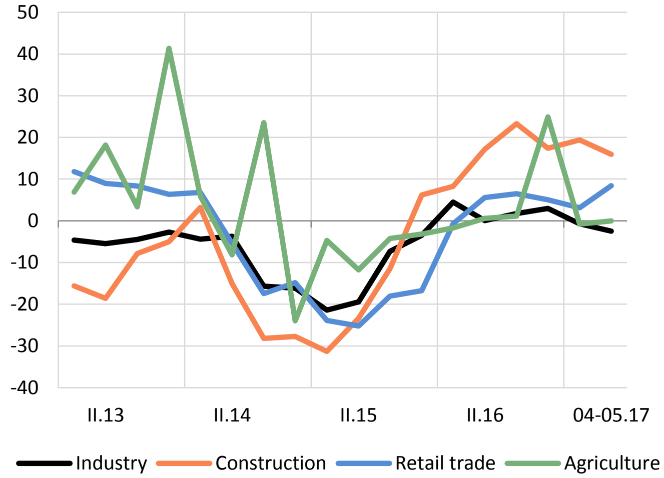
The NBU's estimates show that consumer demand continued to grow in Q2 due to higher real wages, positive consumer expectations owing to the hryvnia's appreciation against the USD, and a gradual revival of consumer lending.

Real GDP, Index of Key Sectors Output and Business Expectations



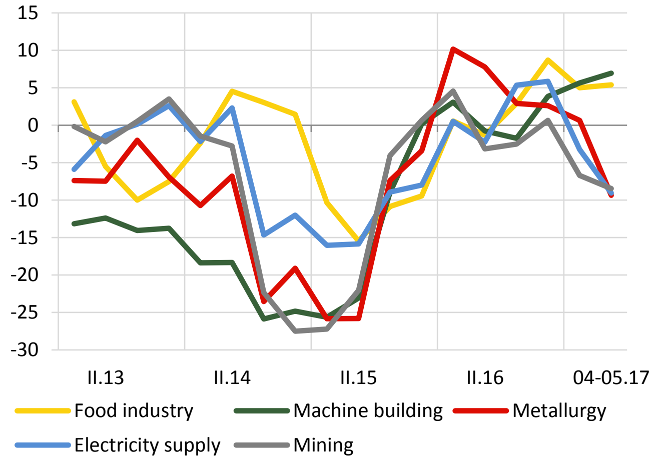
Source: SSSU, NBU staff estimates and surveys

Output by Certain Types of Activity, % yoy



Source: SSSU, NBU staff estimates

Output by Certain Manufacturing Industries, % yoy



Source: SSSU, NBU staff estimates

[25] In 2017, the heating season ended in early April as opposed to mid-April as usual.
[26] Crop productionis included in the agricultural production index from June to December.
[27] Pig breeding by agricultural companies is denoted in live weight.
[28] After taking steps to stabilize the situation with avian flu in Ukraine, the State Service of Ukraine for Food Safety and Consumer Protection sent official requests to Ukraine's trade partners asking them to review their decisions to ban Ukrainian poultry imports. Following the request, some countries have lifted their bans.

2.2.3. LABOR MARKET AND HOUSEHOLD INCOME

In January-May 2017, demand for labor continued recovering at a moderate pace. However, the recovery was held back by weaker economic activity as a result of the suspension of trade with the non-government controlled area (NGCA) and the seizure of companies located in those territories, as well as business adopting a cautious approach to raising headcounts owing to higher labor costs. That cautious approach is also evident in the staff cuts that have taken place since the start of the year (seasonally adjusted figures). Moreover, the labor market is still marked by significant mismatches in supply and demand. This has led to a slight increase in the unemployment rate, calculated in seasonally adjusted terms according to International Labor Organization (ILO) methodology.

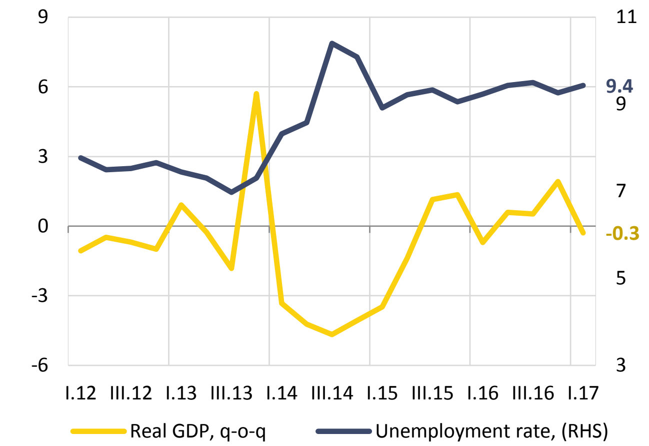
In Q1 2017, nominal household income growth accelerated materially, mostly owing to the doubled minimum wage and a greater number of households covered by the housing subsidy program. However, growth in incomes from other sources remained sluggish and some income streams declined. These factors held back real disposable household income growth from accelerating, although it still grew 2.4% yoy after a drop in the previous quarter. At the same time, household savings continued to decrease in Q1 2017. With high utility prices and an elevated unemployment rate, households continued to rely on savings for consumption.

The Labor Market

In January-May 2017, demand for labor continued recovering. Data from the State Employment Service of Ukraine (SESU) and employment websites showed the growth in labor demand. According to the SESU, those sectors that showed the highest economic activity also showed a significant increase in the number of vacancies: transport, construction, trade, and processing accounted for more than 60% of all vacancies. At the same time, areas with declining economic activity also reported an increase in vacancies, especially finance, insurance, electricity production, water supply, and mining. That could be the result of employers setting high qualification requirements for job candidates, as well as the persistent mismatches in the labor market. Differing ratios for the number of candidates to the number of vacancies across sectors attest to the mismatches in the labor market. According to employment websites as of May 2017, the area of law showed the highest ratio (83 candidates per vacancy), followed by administrative work (43 candidates per vacancy), education and science (41 candidates per vacancy), and finance and banking (36 candidates per vacancy). Overall, despite an increase in the number of vacancies, labor demand remained moderate against a slight decline in the load of unemployed per one vacant work place.

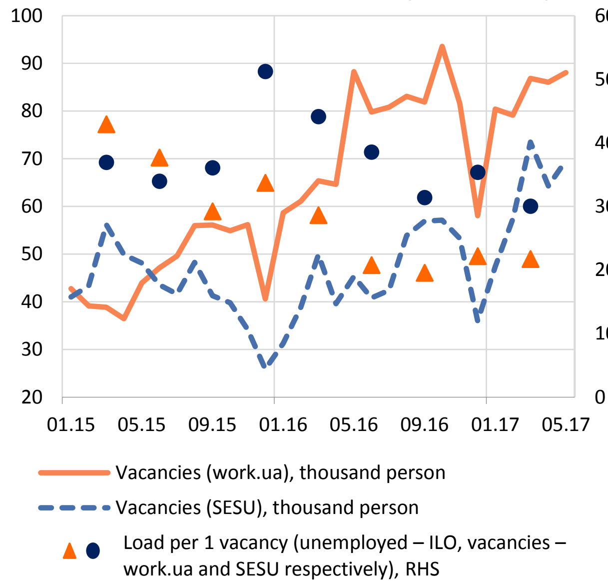
In Q1 2017, the number of economically active individuals continued decreasing (by 0.8% yoy to 17.7 million), largely reflecting demographic factors and migration. However, the level of economic activity also decreased (to 61.4%), a sign

ILO Unemployment* and Real GDP, sa, %



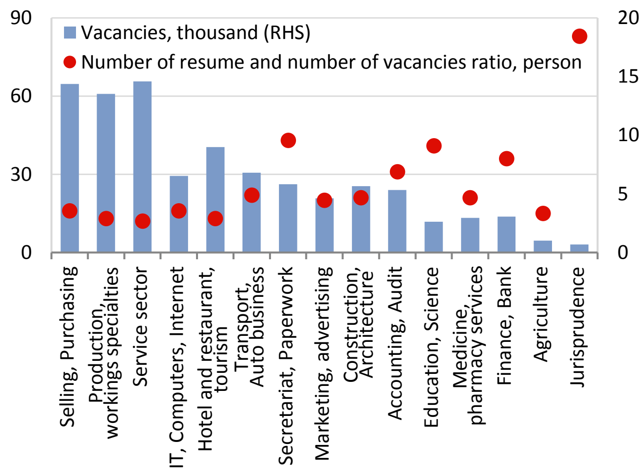
** % of economically active population aged 15 – 70 years*
Source: SSSU, NBU staff estimates

Vacancies SESU and on work.ua, Load per 1 Vacancy



Source: SSSU, www.work.ua, NBU estimates

The Share of Vacancies on www.work.ua, Number of Resume and Number of Vacancies Ratio for Activities (May 2017)



Source: www.work.ua, NBU estimates

of growth in the number of economically inactive individuals[29].

The number of employed individuals also fell (by 1.1% yoy to 15.9 million), declining faster than the economically active population. The decrease took place mostly among women and was accompanied by a drop in part-time staff (short working day/week). According to the SESU, in Q1 2017, the number of individuals forced into a part-time work for economic reasons stood at 2.7% of the average number of staff (or 211,000 individuals), which is 40% lower than in Q1 2016.

In January-May 2017, the number of staff employees, who account for almost half of the employed population, declined 1.9% yoy to 7.7 million individuals. This was mostly the result of the seizure of companies in the NGCA and, correspondingly, their exclusion from statistical reporting (staff numbers had been decreasing at a faster pace in those regions). Additionally, this may have been the result of businesses being cautious about raising employment in light of higher labor costs. Staff numbers decreased in most industries except land transport, pipelines, air transport, and warehousing. At the same time, with the exception of agriculture, the number of employees in sectors with higher unofficial labor rates declined faster than the average for the economy. This was particularly true in sectors like construction and trade.

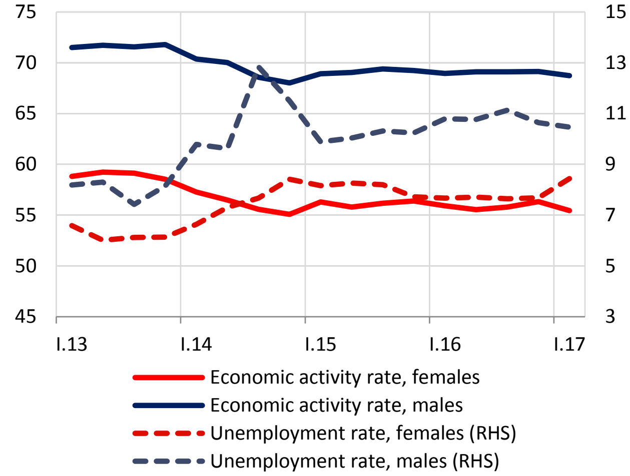
As a result, the ILO unemployment rate (in percent of the economically active population aged 15 to 70) increased to 10.1%. The growth is partially the result of seasonal workers (mostly males in construction and agriculture) starting to look for a job. In seasonally adjusted terms, the unemployment rate among males decreased even as overall unemployment rose to 9.4%. This was driven by atypical growth in unemployment among females, which was highest for females aged 30-49.

Growth in unemployment amid a gradual increase in labor demand is also a sign of significant mismatches on the labor market. In Q1 2017, individuals aged 15-24 years had the highest unemployment rate (17.7%, owing to difficulties finding jobs after graduating), while regionally, Luhansk and Donetsk oblasts reported the highest unemployment at 17.0% and 15.2%, respectively. Moreover, according to the SESU, as of 1 June 2017, almost 40% of all vacancies were located in the city of Kyiv, Lviv oblast, Dnipropetrovsk oblast, and Kyiv oblast.

Household Income and Savings

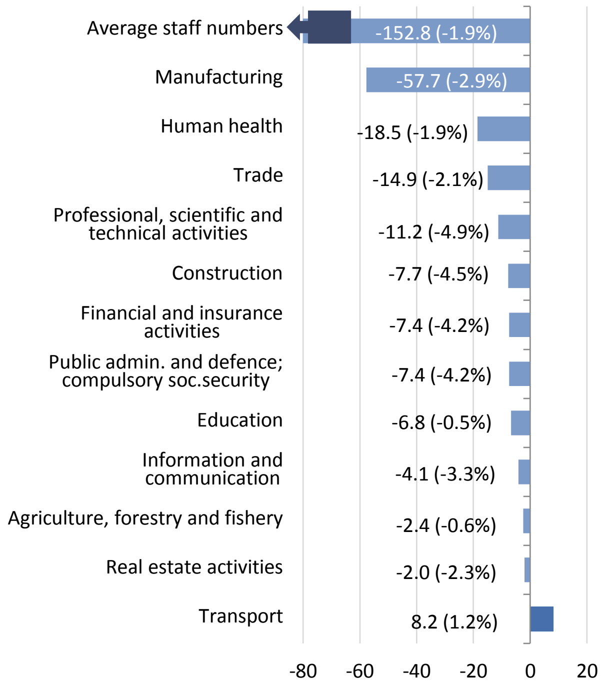
Nominal household income growth accelerated considerably in Q1 2017. The growth was driven by the largest income components: social benefits and other current transfers received (+31.8% yoy) and wages (+25.9% yoy).

Economic Activity Rate, % of the population aged 15-70, and ILO Unemployment Rate, % of the economically active population aged 15-70, by sex, sa



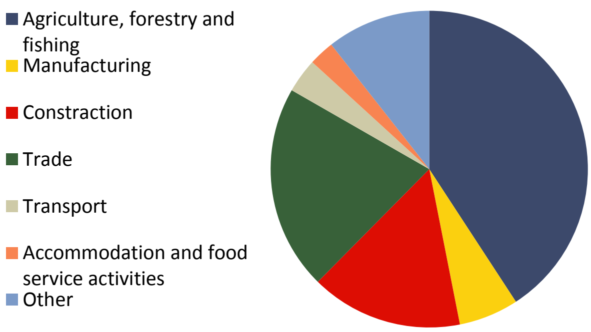
Source: SSSU, NBU staff estimates

Change of Staff Quantity for Activities in January-May 2017, compared to the corresponding period in 2016, thousand person and %



Source: SSSU, NBU estimates

Structure of Informal Employment for Activities, 2016, %



Source: SSSU

[29] This category includes individuals who do not want to work because they have no need to work (such as retirees, students, housekeepers), individuals who have lost hope of finding a job, and those who feel there is no suitable work and do not know where and how to find it. Read more about the structure of the population in the Box *Unemployment Level by ILO Methodology* in the September 2015 Inflation Report, pages 24-25.

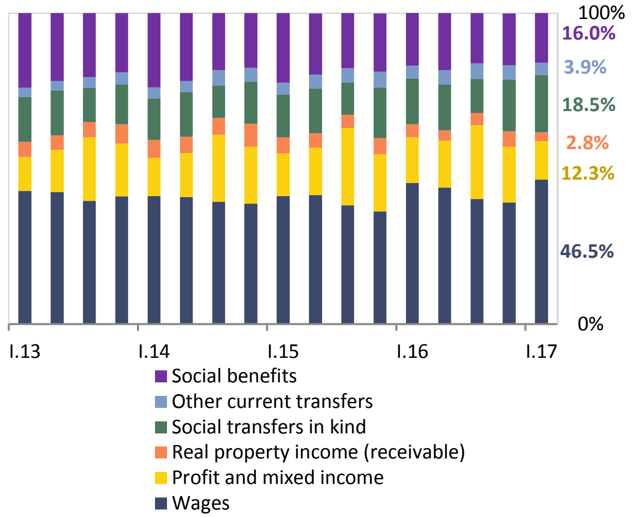
A significant factor was the expansion of the housing subsidy program to cover a greater number of households and a year-on-year increase in the amount of subsidies. This boosted the growth of social transfers in-kind (to 54.4% yoy), while their share in household income rose to 18.5% exceeding income received as social allowances (including pensions and allowances paid by the Pension Fund).

The twofold increase in the minimum wage to UAH 3,200 as of 1 January 2017 caused wages to increase their share of household income [30] to 46.5%.

Those factors contributed to the renewed growth of real disposable household income after a drop in the previous quarter. However, the growth remained moderate as nominal income from other sources grew slowly and as annual inflation accelerated. Nominal incomes from business activity (profits and mixed incomes) grew only 3.2% yoy, while property income decreased 18% yoy. The growth of household income from social benefits accelerated to 16.2% yoy, partially owing to a low comparison base.

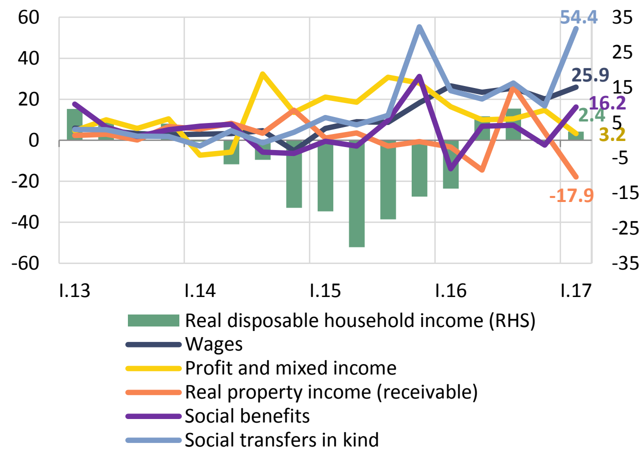
The increase in nominal household income was an important factor in the revival of private consumption. At the same time, households continued to tap savings to maintain consumption levels. In Q1 2017, household savings decreased by UAH 44.3 billion. This was driven by an accumulation of non-financial assets (primarily due to residential property depreciation) and lower growth rates of financial assets (as individuals sold more foreign currency).

Structure of household income, %



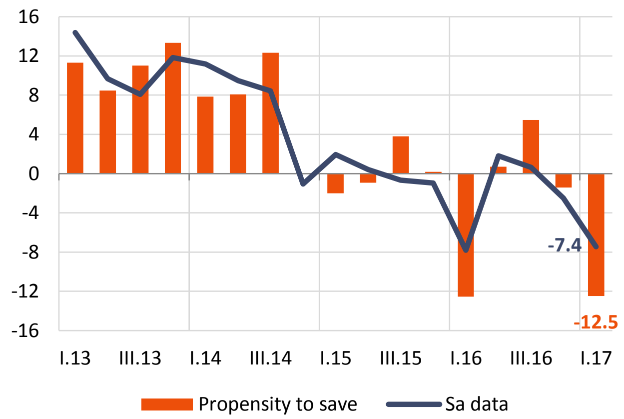
Source: SSSU, NBU estimates

Real disposable household income and components of nominal household income, % yoy



Source: SSSU

Household Propensity to Save*, %



**Savings to disposable household income ratio*
Source: SSSU, NBU staff estimates

[30] The growth rates of wages within the structure of income and the average nominal wage (per one employee) differ due to the different calculation methodologies used. The share of wages in household income is calculated based on a larger sample, which includes, among other things, armed forces pay and allowances, temporary disability payments, and self-employment income, as well as other payments that are not included in the calculation of the average nominal wage per employee.

2.2.4. FISCAL SECTOR

In January-May 2017, Ukraine continued to pursue a prudent fiscal policy. Economic factors, including an improvement in corporate earnings and household finances, as well as an acceleration of import growth, and tax changes introduced early this year allowed the growth of tax revenues to remain high. In addition, non-tax proceeds and other revenues grew thanks to the confiscation of funds and the transfer of the NBU's profit for the previous year. As a result, consolidated budget revenues grew substantially.

At the same time, expenditures rose sharply over the first two months of 2017, but this was offset by a slowdown in March-May, especially in social spending. Transfers to the Pension Fund decreased (owing to rapid growth of the single social security contribution (SSC)), as did expenditures for household benefits and utilities subsidies. The latter was driven by the early end of the heating season in Ukraine and technical factors related to changes to the allocation of subsidies. In the meantime, capital expenditures continued growing, including through funds received from the "customs experiment".

Overall in January-May 2017, the consolidated budget recorded large overall and primary surpluses, even excluding non-recurring proceeds[31].

Public and publicly guaranteed debt stood at UAH 1,968 billion as of the end of May 2017, virtually unchanged from the start of the year despite the substantial issuance of domestic government bonds for quasi-fiscal financing needs and the receipt of funds from international partners.

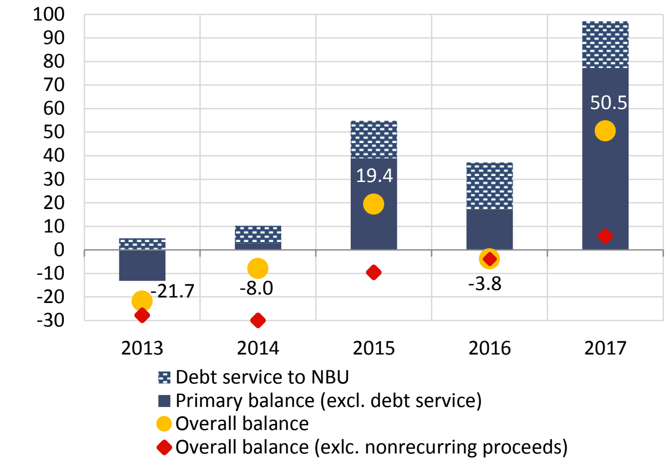
Revenues

Consolidated budget revenues grew 46% yoy in January-May 2017. In contrast to Q1 when taxes drove substantial revenues, in April-May non-tax proceeds and other revenues were an additional revenue source. The transfer of confiscated funds (UAH 29.7 billion) into the budget boosted other revenues, while the transfer of a portion of the NBU's profit (UAH 15 billion) took place in a different period than last year, which drove the large increase in non-tax proceeds.

Through the first five months of the year, tax proceeds increased 31.1% yoy owing to economic factors (growth in retail trade turnover, strong imports, and the improved financials of businesses and households) and tax changes introduced early in the year (an increase in excises for certain goods, rent indexation, changes in VAT taxation, etc.). Revenues from personal income tax continued growing steadily during the period as nominal wages grew further, including after the minimum wage doubled early this year.

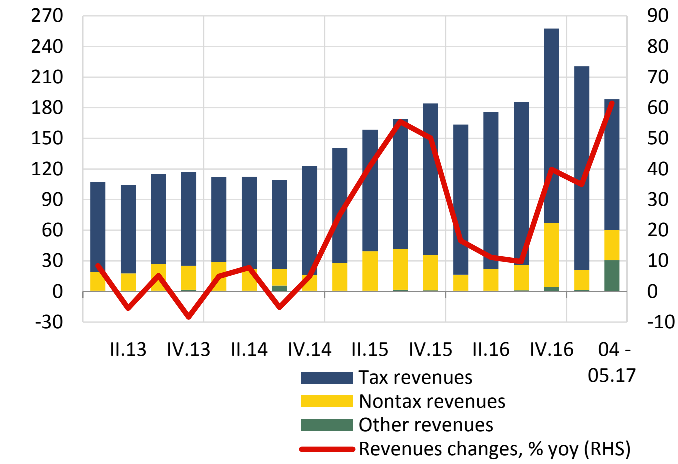
Large corporate profit tax proceeds received in April-May helped recoup a decrease in Q1 that was caused by changes

Consolidetad Budget Balance in January-May, UAH bn



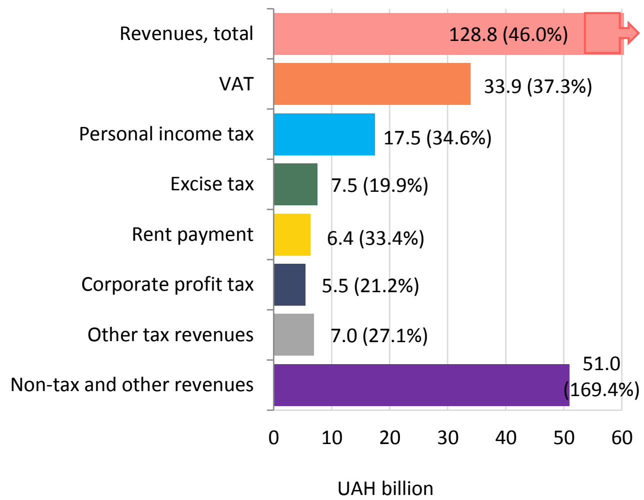
Source: STSU, NBU staff estimates

Consolidated Budget Revenues, UAH bn and yoy change, %



Source: STSU, NBU staff estimates

Consolidated Budget Revenues in January-May 2017, compared with the previous year, UAH bn and %



Source: STSU, NBU staff estimates

[31]Non-recurring proceeds include profit from the NBU, receipts from the sale of 3G telecommunications licenses, and confiscated funds.

in the administration of that tax in 2016 [32] and also drove year-on-year growth in the cumulative amounts for January-May 2017. An improvement in corporate earnings (including at state-owned companies) was a major driver of the large proceeds in corporate profit tax – the profits of profitable companies increased 61% yoy in Q1.

Growth in proceeds from excise taxes also continued at a strong pace in April-May. An increase in excise tax rates for certain excisable goods – especially alcoholic drinks and tobacco products – in Q1, a revival in retail trade, and large import volumes contributed to the overall growth. The strong import volumes also impacted receipts from taxes on international trade, which continued to grow. Moreover, rent proceeds continued to grow, particularly owing to the indexation of rates and a slight increase in local gas production.

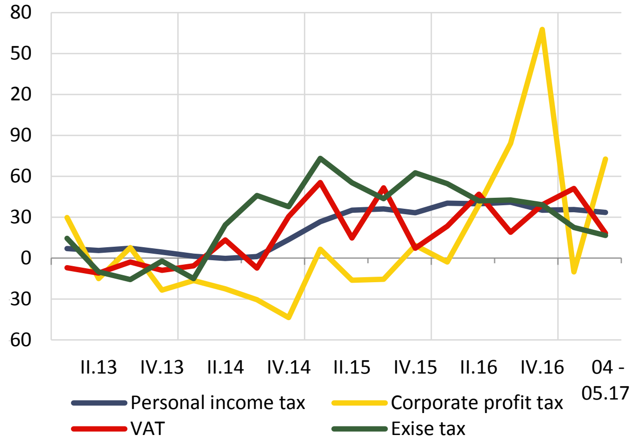
At the same time, in April-May, VAT revenues grew moderately, by 18.2% yoy (down from 51.0% yoy in Q1), which was then reflected in a slowdown in the growth of total tax revenues, as VAT accounted for 36.2% of all tax revenues in 2016. An increase in VAT refunds was the major cause of the deceleration of growth in VAT proceeds. The government refunded UAH 21 billion in April-May, 51.7% higher year-on-year. The increase was prompted by the launch of the single electronic register for VAT refunds. That has resulted in a decline in refund arrears to UAH 13.7 billion as of the end of May 2017 after they increased sharply early this year. At the same time, the full changeover of agricultural producers to the general VAT system and the implementation of a single tax rate for natural gas for all market players during customs clearance, which is taking place at a time of high import volumes, have resulted in substantial growth of VAT revenues since the start of the year.

Expenditures

After rapid growth in consolidated budget expenditures in the first two months of 2017, spending growth slowed materially in March-May, primarily on lower social spending. However, total expenditures still rose 26.5% yoy through the first five months of the year.

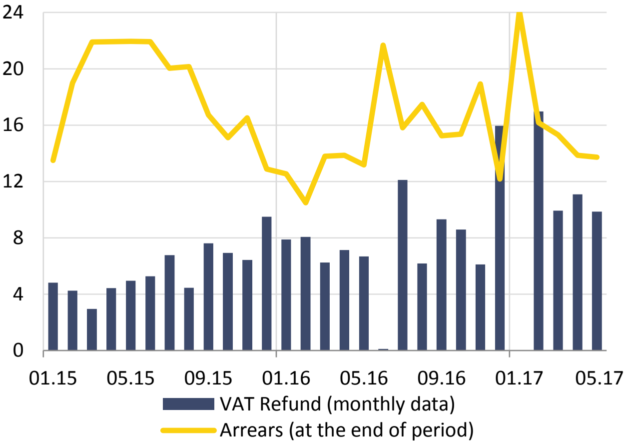
After social security expenditures soared 46.5% yoy in Q1, they decreased 14.3% yoy in April-May. This was primarily driven by a sharp decline in household benefits and subsidies for utility payments. In the first two months of the year, these expenses were four times higher year-on-year owing to higher public utility rates and a larger number of households covered by the subsidy program. Nevertheless, the warmer weather in March led to an early end to the heating season, which, along with some technical factors[33], resulted in an 18.8% yoy decrease in those expenses in March-May 2017. At the same time, in March-May, budget

The Main Budget Taxes, % yoy



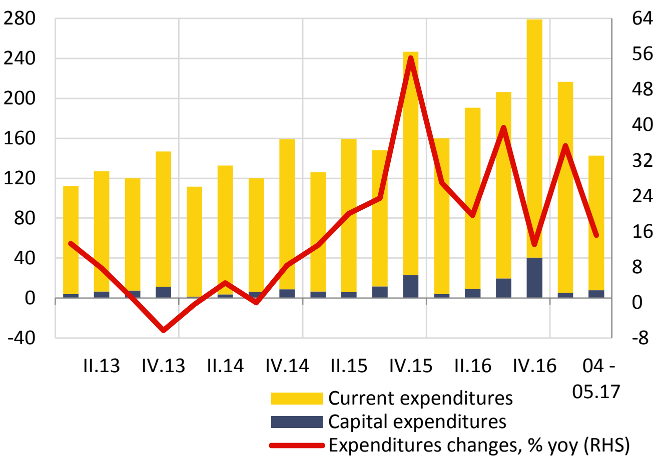
Source: STSU, NBU staff estimates

VAT Refund Payments and the Stock of VAT Refund Arrears, UAH bn



Source: STSU, SFS, NBU staff estimates

Consolidated Budget Expenditures, economic classification, UAH bn and % yoy



Source: STSU, NBU staff estimates

[32]Starting in 2016, the payment schedule for corporate profit tax reverted to a quarterly cadence. Previously, the tax had been paid in monthly advance installments. Accordingly, in Q1 2016 (primarily in March as the final deadline falls on this month), companies paid the tax based on 2015 results, accounting for previously paid advance payments. In Q1 2017, most companies paid the tax based on Q4 2016 results, accounting for advance payments made in Q4 2016. In addition, the final payment deadline moved to February. Therefore, based on the January-February 2017 figures, proceeds from this tax grew substantially, albeit staying lower than in Q1 2016.

[33]Social security bodies were unable to issue subsidies in May because of technical reasons after the Cabinet of Ministers of Ukraine adopted Resolution No. 300 *On Amending Certain Resolutions of the Cabinet of Ministers of Ukraine* dated 26 April 2017. The subsidy for May will be reflected in the next period. Read more at http://kyivenergo.ua/news/512.

transfers to the Pension Fund were lower than last year as the Pension Fund received more of its own funds thanks to growth in SSC proceeds (34.6% yoy over January-May 2017). In addition, growth in compensation of employees slowed in April-May against a high comparison base.

Other current expenditures continued growing rapidly. In April-May, spending on the consumption of goods and services grew 56.7% yoy driven by growth in spending for government (regional) programs and payments for other services. Expenditures on subsidies and current transfers to corporations and enterprises also increased substantially. On the other hand, growth of debt servicing expenses remained moderate, level with the previous quarter.

Capital expenditures continued to grow rapidly (50.2% yoy in April-May) despite a higher comparison base. As a result, capital expenditures in January-May 2017 came in well above last year's level. Traditionally, local budgets were the source of capex financing, particularly to improve roads. This was related to a speed-up in implementation of the "customs experiment", aimed at financing road infrastructure using excess customs proceeds[34].

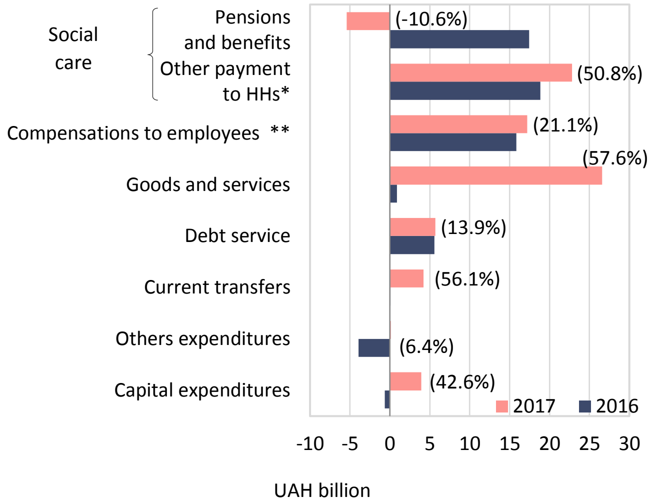
By the functional classification of expenditures, spending on education and healthcare grew rapidly. The increase in those expenditures reflected first of all rising salaries, particularly following the minimum wage increase. At the same time, spending on medicine and bandages declined, while actual expenditures from the general fund of the state budget were significantly lower than planned, especially in healthcare. Expenditures also grew rapidly in economic activity, public utilities, and sports, culture and media, especially related to Ukraine's hosting of the Eurovision Song Contest in May 2017.

Balance

With high revenues and moderate expenditures, the state budget recorded a strong surplus in April-May, offsetting the deficit recorded in Q1. Local budgets also posted surpluses. As a result, the consolidated budget generated a large surplus and, including the Q1 result, the surplus for January-May came in at UAH 50.5 billion. The primary balance of the consolidated budget was large as well. The primary balance was also positive when normalized for the same conditions as in 2016 by excluding revenue streams that were not present during the same period of the prior year. Among other factors, this was driven by a gradual decrease in the cost of borrowings secured by the MFU in the domestic market and, accordingly, their servicing cost, as the NBU reduced the key policy rate.

Despite the state budget surplus, the government continued offering short- and medium-term domestic government bonds to pay off previously issued government securities. As in previous periods, securities with maturities of longer than one year were preferred as a way of reducing the burden on this year's budget. At the same time, the

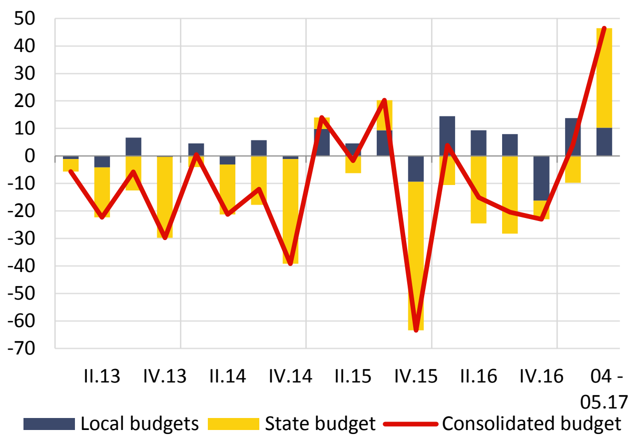
Consolidated Budget Expenditures in January-May, economic classification, UAH billion (% yoy in 2017)



** Other payments to the population include benefits and subsidies to households for utility payments, scholarships, etc.*
*** Wages, salaries to military officers, and payroll charges*

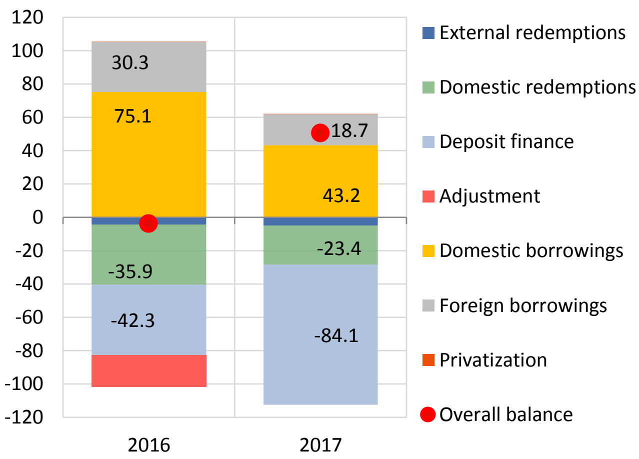
Source: STSU, NBU staff estimates

Consolidated Budget Bbalance, UAH bn



Source: STSU, NBU staff estimates

Consolidated Budget Balance Financing in January-May, UAH bn



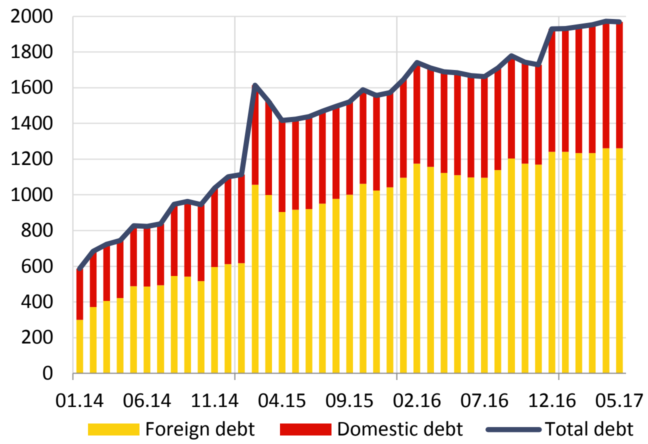
Source: STSU, NBU staff estimates

[34]The experiment of financing road development is regulated by clause 33, section VI *Final and Transitional Provisions* of the Budget Code of Ukraine. Under the plan, 50% of the above-target portion of the total monthly indicative proceeds from customs duties, excise taxes, and VAT on imported goods will be allocated to special funds within local budgets to finance the reconstruction and repair of roads. The so-called "customs experiment" was launched in September 2015 in four oblasts. Kyiv was added in 2016 and all Ukrainian oblasts were included as of 2017. The project will run until 1 January 2018.

issuance of domestic government bonds for quasi-fiscal needs continued: the government raised UAH 26.4 billion to support state-owned banks. In addition, after receiving another tranche from the IMF, international partners, particularly the European Union, also contributed financing.

Despite large issues of domestic government bonds and external borrowings, Ukraine's public and publicly guaranteed debt grew just 2.0% as of the end of May from the start of 2017. The hryvnia's appreciation against the US dollar partially offset the debt growth as a substantial portion of the debt was denominated in foreign currency (almost 70% of all public and publicly guaranteed debt as of the end of May 2017, while the USD-denominated debt accounted for 60% of all FX-denominated debt).

Public and Publicly Guaranteed Debt, UAH bn



Source: MFU, NBU staff estimates

2.2.5. BALANCE OF PAYMENTS

Ukraine posted a current account deficit of USD 0.3 billion in April-May 2017 after generating a surplus in the same period last year. Merchandise trade posted a deficit, which was the main contributor to the current account deficit. Growing global energy prices amid a domestic shortage of coal and higher supplies of natural gas year-on-year drove a significant increase in imports of goods. At the same time, the suspension of trade with the non-government controlled areas (NGCA) slowed the growth of goods exports.

Net financial account inflows increased to USD 1.6 billion. The successful third review of the EFF program with the IMF allowed the government to receive another tranche of macro-financial assistance from the European Commission. A decrease in FX cash outside banks and an increase in trade credits resulted in net inflows to the real sector. The private sector generated net debt capital inflows in April-May.

As of the end of May 2017, international reserves grew to USD 17.6 billion (or 3.6 months of future imports) thanks to a surplus of the overall balance of payments (USD 1.3 billion) in April-May and the loan tranche received from the IMF (USD 1.0 billion).

Current Account

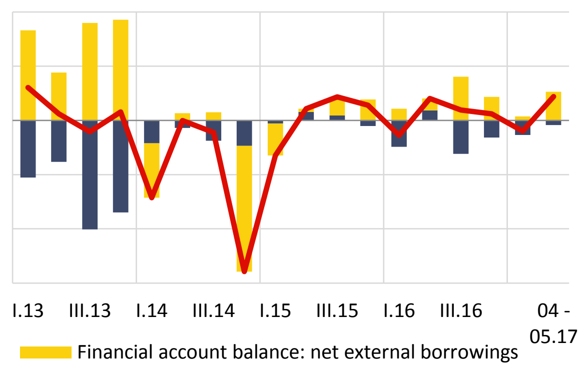
Global demand for Ukrainian goods remained strong, while the metals and mining sector experienced difficulties after trade with the NGCA was suspended. These two factors influenced merchandise trade most significantly in April-May 2017. At the same time, despite a less favorable global price environment compared with the previous quarter, prices for most key Ukrainian export goods remained higher than last year.

Growth in goods exports slowed to 14.6% yoy, driven primarily by metal products. The suspension of trade with the NGCA caused a temporary decrease in volumes of ferrous metals exports. However, the value of metals exports remained higher than last year thanks to robust prices[35]. An increase in monthly export volumes partially offset the April-May drop in global iron ore prices compared with Q1 2017. As a result, despite a significant deceleration, annual growth in the value of iron ore exports remained high in April-May (45.9% yoy).

Exports of food products also grew rapidly, primarily on the back of volume growth. In April-May, 7.3 million tons of grain were exported, 20% higher yoy. Exports of corn to Europe grew the most, although Egypt remained the main consumer of Ukrainian corn. Sunflower oil export volumes grew 28% yoy, and India and Europe remained the main importers.

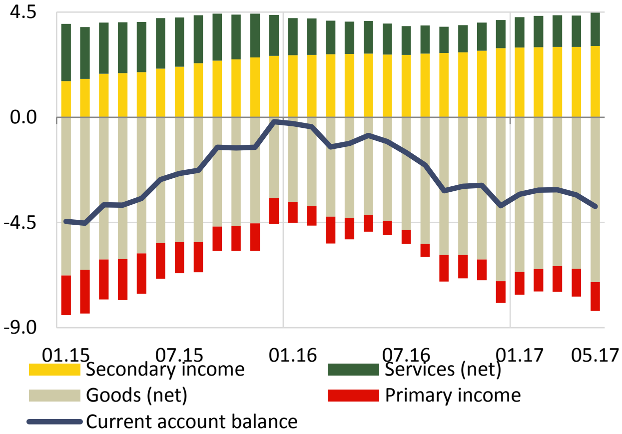
Thanks to strong trade relations with other countries, exports of other food products (except grains and oil crops)

Overall Balance of Payments, USD bn



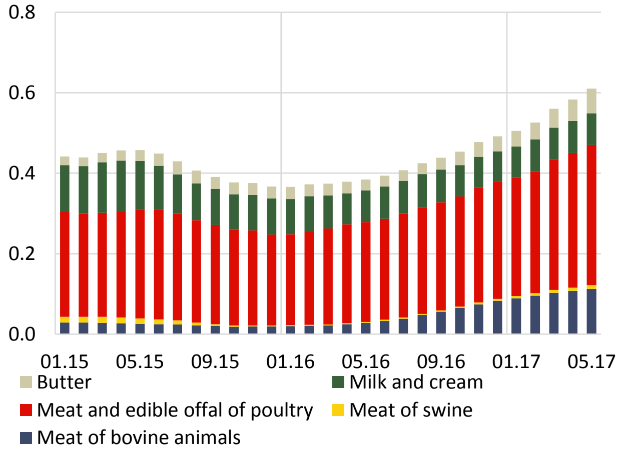
Source: NBU

Current account balance, 12 month cumulative, USD bn



Source: NBU

Exports of selected foods products without Russia, 12 month cumulative, USD m



Source: NBU

[35]Global price changes impact Ukrainian export prices with a small lag of 2-3 months (NBU estimates) because contracts are concluded beforehand and because of other factors.

also grew rapidly. For example, meat supplies increased 1.6 times compared with April-May 2016. Exports of meat and edible meat offal of poultry – which account for around 80% of all meat exports – grew 44% yoy. Egypt, the Netherlands, and Azerbaijan are the major consumers of Ukrainian poultry. Pork exports grew 7.5 times, although volumes remain substantially lower than before Russia imposed an embargo in 2015. Growth in exports of dairy products accelerated to 48.1% yoy on higher supplies of butter. In 2017, Ukraine became a top-five global exporter of butter, with CIS and African countries the main consumers.

However, a less favorable price environment slowed growth in the value of food exports over April-May to 22% yoy.

Machinery exports grew 2.3% yoy as turbo-jets exports to Russia made a major contribution. In addition, Ukraine's production of components for global automobile companies (primarily electric parts) has increased in recent years. Germany, Hungary, and Poland were the main consumers of these products.

By broad economic categories, growth in exports of intermediate consumption goods was the key driver of export growth in January-April (up 29% yoy). At the same time, exports of consumer goods grew fastest (36% yoy) and their share increased to 16.4%.

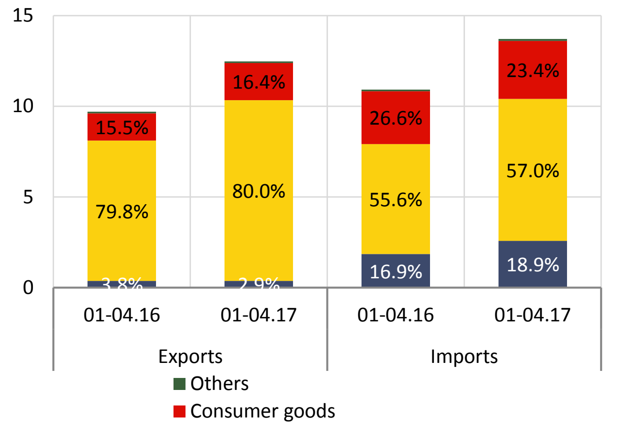
Growth in the value of goods imports accelerated to 25.3% yoy in April-May – primarily on increased purchases of energy resources, especially coal and natural gas.

In April-May, energy imports grew 1.9 times yoy. A shortage of coal on the domestic market after the suspension of trade with the NGCA and high external prices have driven coal imports to rise 2.1 times. Coal supplies from the US grew most, although Russia has remained Ukraine's main supplier of coal. However, with low gas imports in April-May 2016 (due to large storage inventories after a relatively warm winter), gas imports increased almost five times in annual terms, despite a slowdown in price growth. The annual growth rate of the value of oil product imports declined to 20.4% on the back of a deceleration in the annual growth of global oil prices, while volumes remained practically the same as one year ago.

High crop yields in recent years, the agriculture sector's further growth potential, and large export proceeds have pushed agricultural producers to invest actively. This investment activity has been largely covered by imports. Imports of agricultural machinery and equipment grew 40% yoy in April-May. Imports of tractors, which account for 40% of all agricultural machinery and equipment imports, increased 1.7 times. The US and Germany were the main suppliers of the tractors. In addition, fertilizer import volumes grew 2.1 times as supplies from Ukrainian producers decreased and ahead of the introduction of anti-dumping duties on Russian fertilizers.

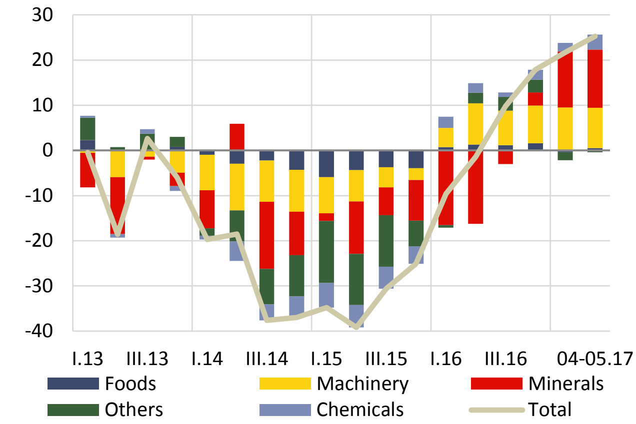
An increase in consumer demand amid a moderate appreciation of the real effective exchange rate (REER) of

Exports and Imports be Broad Economic Categories, USD bn



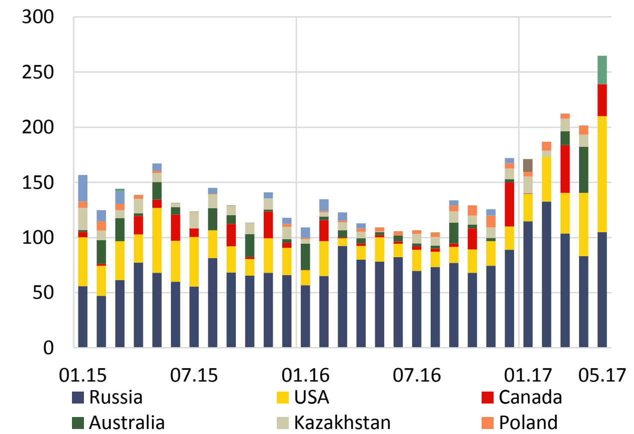
Source: NBU

Contribution to Imports Annual Change, p. p.



Source: NBU

Coal Imports by Countries, USD thsd



Source: NBU, SFS

the hryvnia caused an acceleration in the growth of consumer imports: imports of food products increased to 5.4% yoy, clothing and footwear imports grew to 15.5% yoy. In addition, pharmaceutical imports grew 9.2% yoy as the state-run procurement system for pharmaceuticals is being gradually established.

By broad economic categories, imports of capital goods continued growing rapidly (40% yoy) in January-April, primarily in vehicles. Imports of intermediate consumption goods also increased (28.6% yoy in January-April) on imports of energy resources. The growth of consumer goods imports was more moderate at 10.5% yoy.

In April-May, the surplus in trade in services grew to USD 322 million. Growth in services exports accelerated to 21.4% yoy thanks to greater volumes of IT services provided to non-residents (26.1% yoy) due to the elimination of administrative barriers to services exports in late 2016, as well as other factors. Exports of pipeline transport services also remained high – gas transit volumes to Europe increased 25% yoy. Imports of services also grew and accelerated to 9.9% yoy, primarily on imports of travel services.

Repayments increased after dividends repatriations were allowed for 2016, but these were offset by higher worker's remittances, which netted the primary income account out to close to zero in April-May.

Financial Account

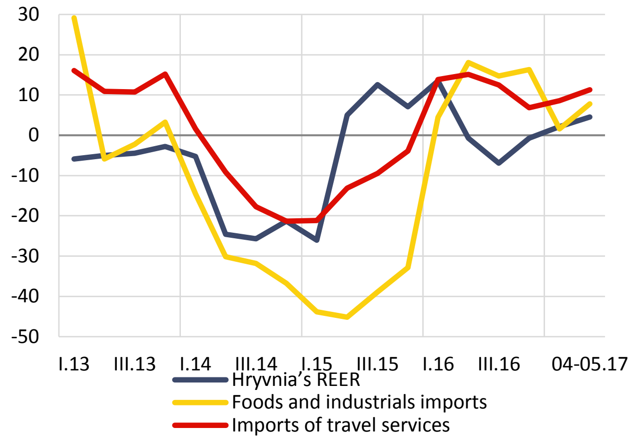
In April-May 2017, net financial account inflows increased to USD 1.6 billion. Unlike in the previous quarter, both the public and private sectors generated inflows. The successful third review of the EFF program with the IMF allowed the government to receive another USD 0.6 billion of macro-financial assistance from the European Commission. Net borrowings by the real sector (USD 1.2 billion) resulted from a decrease in FX cash outside banks (USD 0.6 billion), growing trade credits (USD 0.5 billion), and proceeds from corporate Eurobond placements (USD 0.2 billion). The banking sector generated net payments of USD 0.3 billion over the period.

Based on preliminary estimates, foreign direct investment (FDI) in April-May came to USD 57 million, 75% of which was directed to the real sector. At the same time, in Q1 FDI inflows (USD 0.5 billion[36]) consisted mainly of intercompany lending between direct investment companies.

A decrease in FX cash outside banks remained one of the main drivers of a surplus in the private sector's financial account. The pace of the decrease accelerated in April-May[3] as the population sold more foreign currency, which was caused by the appreciation of the hryvnia FX rate against the US dollar, as well as other factors.

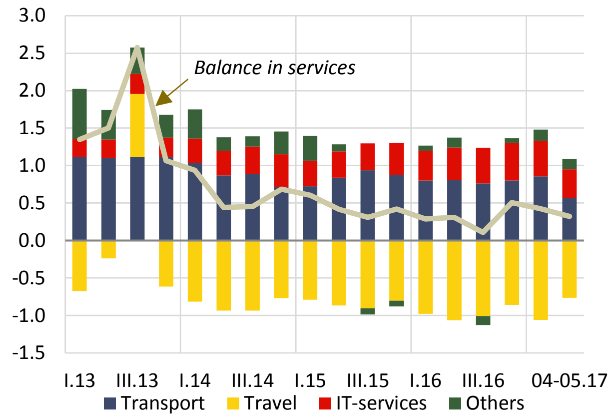
In April-May, the private sector net debt capital inflows reached USD 0.3 billion. An increase in the real sector's

Imports of consumer goods and hryvnia's REER, yoy change in %



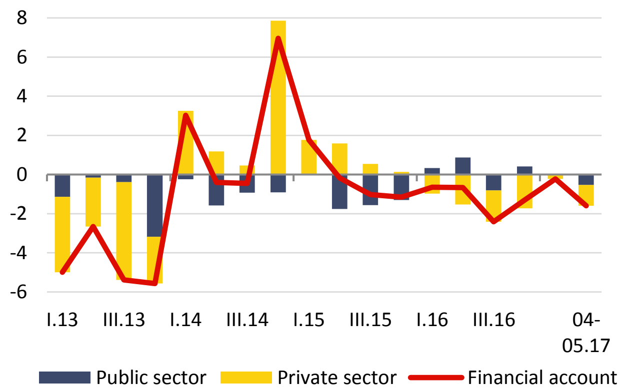
Source: NBU

External Trade in Services, USD bn



Source: NBU

Financial Account: Net External Assets, USD bn



Source: NBU

[36]Q1 data have been updated.

long-term external debt allowed the private sector's rollover rate (77%) to exceed the levels of the previous quarter and the same period last year. The banking sector's rollover rate grew significantly, but this had practically no impact on the overall rollover rate owing to its relatively minor share (less than 10%).

The rollover of long-term private external debt, %[37]

	Q1 2016	Q2 2016	Q3 2016	Q4 2016	2016	Q1 2017	April-May 2017
Banks	31	74	66	73	58	21	60
Corporates	67	53	62	58	60	45	78
Overall	55	56	64	62	59	39	77

Reserve Assets

As of the end of May 2017, international reserves grew to USD 17.6 billion (or 3.6 months of future imports) thanks to a surplus of the overall balance of payments (USD 1.3 billion) recorded in April-May and the loan tranche received from the IMF (USD 1.0 billion).

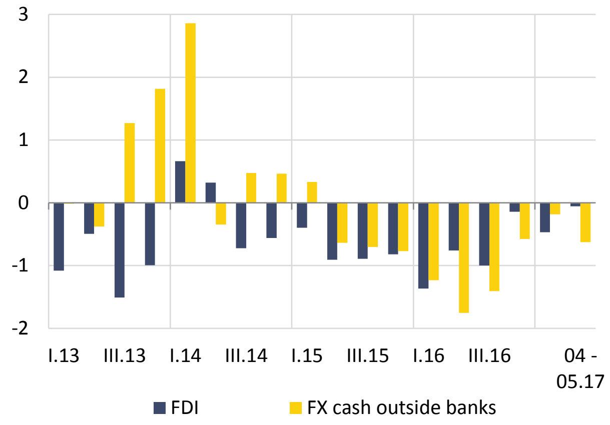
External Sustainability

In Q1 2017, all of Ukraine's external sustainability indicators improved as both GDP and exports of goods and services grew. At the same time, scheduled interest payments on restructured sovereign Eurobonds reduced international reserves in March, which resulted in a slight deterioration of their adequacy as of the end of Q1 2017.

Gross external debt remained almost at the level of the start of the year (USD 113.6 billion, or 117.9% of GDP). Public sector debt increased, while private sector debt decreased. The public sector's liabilities grew slightly (to USD 42.9 billion) after receiving a USD 100 million loan from the Swiss National Bank. At the same time, the repayment of interbank loans reduced the banking sector's debt to USD 8.5 billion from USD 9.0 billion in Q4). Real sector debt remained steady quarter-on-quarter: a decrease in outstanding long-term debt was accompanied by growth in short-term liabilities, while intercompany debt rose by USD 0.4 billion.

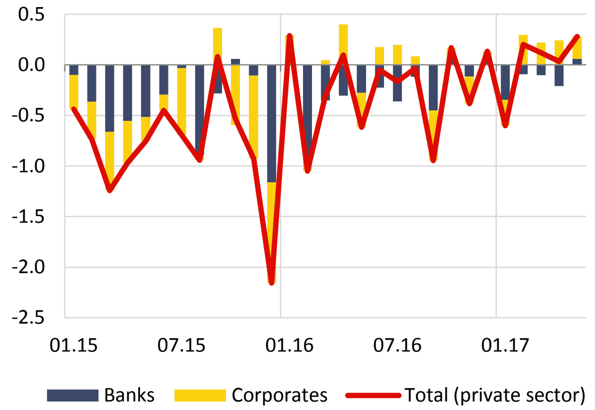
Over Q1, short-term external debt by residual maturity fell to USD 46.2 billion (or 94.6% of exports), primarily owing to a decrease in scheduled payments in the real sector. At the same time, liabilities of the general government and the central bank maturing within the following 12 months grew by USD 2.5 billion, of which USD 1.4 billion are future repayments of IMF loans. As the private sector had limited access to financial markets and the banking sector's long-term debt decreased in previous periods (as a result of debt-to-equity operations), the ratio of short-term debt to total private sector debt remained high at 61.8% in Q1 2017.

FDI* and FX Cash Outside Banks, USD bn



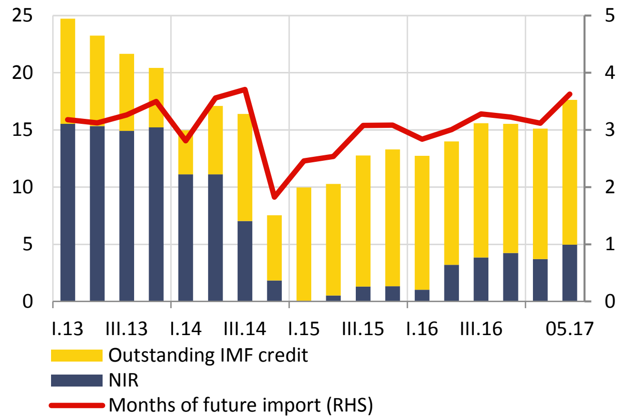
** Minus: inflow*
Source: NBU

Overall Debt Flows*, USD bn



** Plus: inflow*
Source: NBU

Overall International Reserves, USD bn

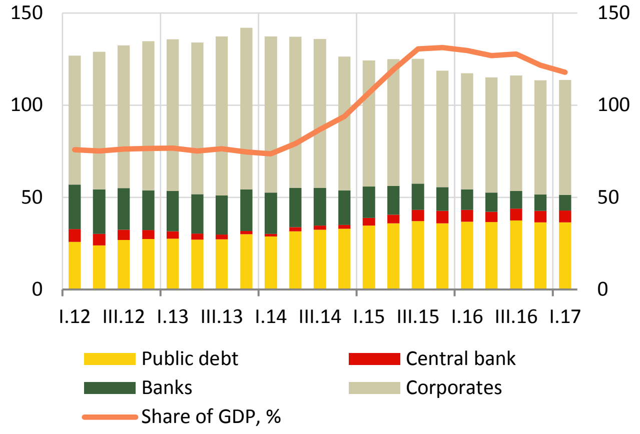


Source: NBU

[37] Excluding debt-to-equity operations.

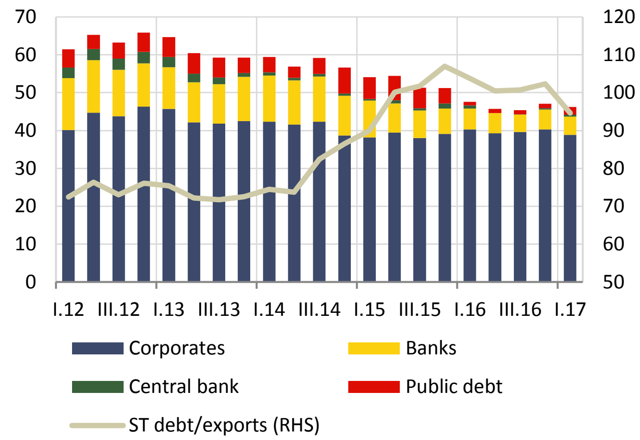
Despite a minor decrease in the amount of international reserves (to USD 15.1 billion, down 2.7% from the start of the year), most reserve adequacy indicators have remained nearly unchanged. The ratio of reserves to broad money and reserves in months of future imports declined by only 0.3 pp and 0.1, respectively. The ratio of reserves to the IMF composite metric (ARA metrics) deteriorated by 1.5 pp and stood at 54.3%. The ratio of reserves to short-term debt (the Guidotti-Greenspan criterion) decreased by only 0.3 pp to 32.7% owing to a proportional decline in short-term debt by residual maturity.

Gross External Debt, USD bn



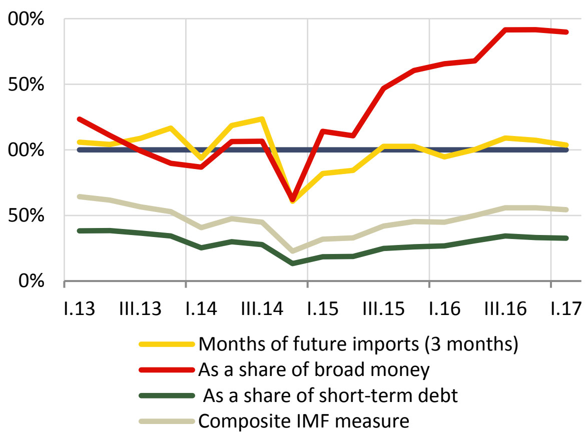
Source: NBU

Short-term External Debt by Remaining Maturity, USD bn



Source: NBU

Adequacy Criteria of International Reserves, %



Source: NBU

External sustainability and international reserve adequacy indicators

%	Q1 2015	Q2 2015	Q3 2015	Q4 2015	Q1 2016	Q2 2016	Q3 2016	Q4 2016	Q1 2017
External debt-to-GDP	106.7	119.3	130.5	131.3	129.7	126.9	127.7	121.8	117.9↑
External debt/exports of goods and services	206.9	229.8	248.3	248.1	255.9	252.8	257.8	247.0	232.7↑
Short-term debt/gross debt	43.5	43.6	41.0	43.1	40.6	39.8	39.1	41.4	40.6↑
Short-term debt/GDP	46.4	52.0	53.5	56.6	52.6	50.5	49.9	50.4	47.9↑
Short-term debt/exports of goods and services	90.0	100.1	101.7	107.0	103.8	100.5	100.7	102.3	94.6↑
Economic openness [38]	106.6	106.9	107.9	107.7	104.5	103.9	104.3	104.8	106.5↓
Reserves/short-term debt	18.4	18.8	24.9	26.0	26.7	30.6	34.4	33.0	32.7 ↓
Reserves, composite IMF measure	31.9	32.9	41.9	45.2	44.8	50.1	55.8	55.8	54.3 ↓
Reserves in months of future imports (3 months)	81.9	84.5	102.6	102.8	94.5	100.2	109.1	107.2	103.6↓
Broad money coverage of reserves	22.8	22.1	29.4	32.1	33.1	33.5	38.3	38.3	38.0 ↓

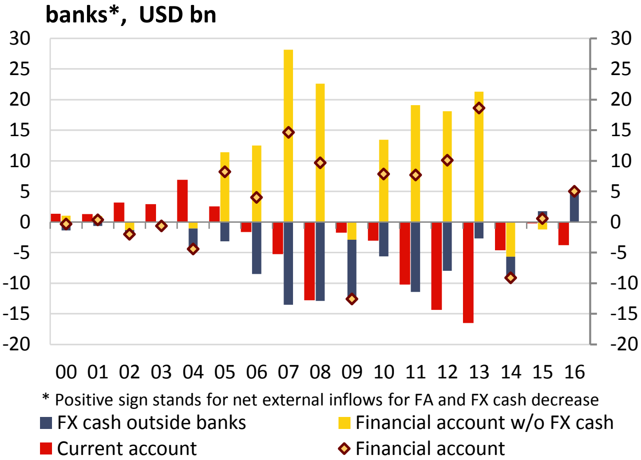
Box: FX Cash outside Banks. Interpreting Recent Trends

Starting in 2015, a decrease in FX cash outside banks accounted for a major share of inflows to the financial account of the balance of payments. In 2016, FX cash outside banks becamethe main source of financing the current account deficit as capital inflows contracted substantially on the loss of access to external financial markets and private debt capital outflows. This structural shift is extraordinary given the accumulation of FX cash outside banks in Ukraine's economy over the preceding 20 years and the severe shocks that hit the country over the last three years. These shocks include Russia's armed aggression and annexation of a part of Ukraine's territory, as well as broad economic and banking crises in a country). Economic research (e.g. T.Scheiber and H.Six (2009)) shows that past macroeconomic instability (high inflation or a significant depreciation of the domestic currency) strongly correlates with the level of dollarization in the country. Therefore, demand for foreign currency can be assumed to increase during periods of significant shocks. In Ukraine, demand for foreign currency was high in 2009, 2014, and H1 2015. However, starting in the mid-2015, this trend reversed.

According to the statistical methodology for compiling the balance of payments, growth of FX cash outside banks is the difference between foreign currency brought into Ukraine and removed from the country by individuals and through bank FX transactions via the following channels:
– Individuals buying/selling FX cash
– Net cash withdrawals from bank cashiers (card accounts, remittances, loans, deposits, etc.)
– Informal trades
– Migrant workers' cash remittances
– FX cash expenditures by travelers[39].

In 2009-2012, FX cash outside banks grew, mostly owing to net purchases of FX cash by the population. After years of a de facto fixed exchange rate , limited alternative saving instruments amid low trust in the banking system, and a broad preference for foreign currency, large net amounts of foreign currency are purchased to prevent a depreciation of savings.

CA Balance, FA Balance and FX Cash Outside banks*, USD bn



* Positive sign stands for net external inflows for FA and FX cash decrease

Source: NBU

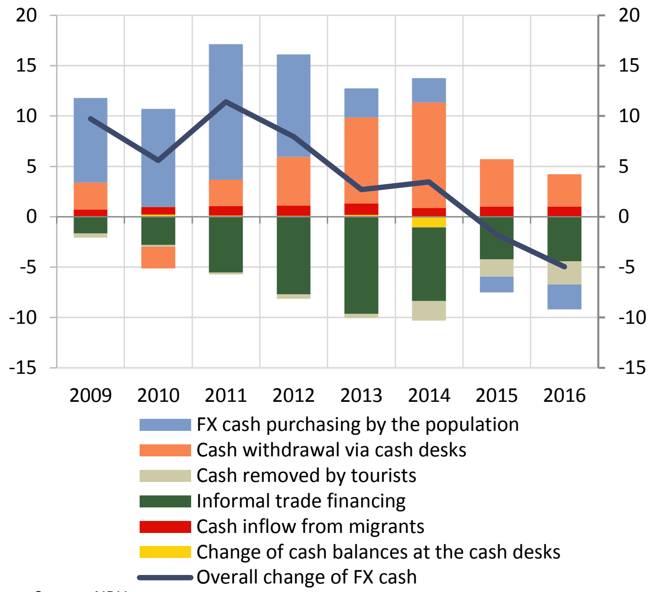
After the NBU imposed administrative restrictions on foreign exchange operations in late 2011[40], net foreign currency purchases started to decline. However, as early as in 2013, the slower growth of household incomes on the back of a stagnation of the economy and the attractiveness of high-interest UAH deposits, as well as low inflation and depreciation expectations for most of the year contributed to a further decrease of net foreign currency purchases. In 2014, administrative restrictions on foreign currency cash purchases were tightened in response to the volatility on the FX market that began in late 2013. Coupled with a steep drop in household income, this led to a continued decline in net purchases of foreign currency cash by the population. Cash withdrawals from bank cashiers, which was the main source of growth in FX cash outside banks during this period, resulted

[38] Calculated as a ratio of the rolling 12-month sum of exports and imports to GDP for a given period.
[39] Experts estimate the amounts of informal trade, cash remittances and FX cash expenditures by travelers. Read more in *The Methodological Commentary on External Sector of Ukraine Statistics*.
[40] The so-called *passportization* of foreign exchange transactions. NBU Resolution No.278 *On Adopting Amendments to the Instruction for Organizing and Performing Foreign Exchange Transactions in Ukraine* dated 11 August 2011.

not only from individuals taking back their foreign currency deposits and more cash being withdrawn from card accounts, but also from fictitious cash transactions by certain banks[41].

In 2015-2016, the amount of FX cash outside banks started to decrease, which was driven primarily by lower cash withdrawals from bank cashiersafter the introduction of stricter controls over cash transactions and restrictions imposed by the NBU in late 2014. Moreover, starting in 2015, the amount of cash sold exceeded the amount of cash purchased, possibly the result of lower real household incomes combined with higher purchases of residential property in the primary market and automobiles. In 2016, this trend strengthened even though the NBU gradually eased the currency market restrictions that had been introduced in 2014-2015. In particular, the trend was driven by an increase in the attractiveness of UAH deposits as interest rates rose and inflation retreated.

Selected items of FX cash outside banks, USD bn



Source: NBU

In terms of other sources of FX cash outside banks, Russia's annexation of Crimea and armed aggression in Eastern Ukraine, caused a substantial decrease in the number of tourists visiting Ukraine after 2014. The effect was made worse as tourism receipts decreased in USD equivalent owing to a significant depreciation of the hryvnia. As a result, individuals travelling abroad took more cash out of the country than they brought in. At the same time, remittances via informal channels have been a stable source of FX cash over the last eight years.

Why should the central bank pay attention to changes in the amount of FX cash outside banks? First, as mentioned above, the decrease in FX cash has become an important source of financing the current account deficit in recent years. Therefore, given the easing of currency market restrictions (read more in the *Measures Taken by the NBU to Liberalize the FX Market and Improve the Functioning of Financial Markets* box), the NBU evaluates the decrease in FX cash when developing its macroeconomic outlook and assessing the risks underlying monetary policy decisions. Second, the high level of dollarization in the economy reduces effectiveness of monetary policy and carries other negative consequences for the economy[42]. Given the potential total amount of foreign currency in Ukraine[43], the country's macroeconomic stabilization, and the NBU's measures to develop a cashless economy, the decrease is likely to continue.

[41]The total amount of those transactions over 2012-2014 is estimated at USD 8.2 billion.
[42]Read more in M. Shkreb and K. Khvedchuk (2016).
[43]See examples in M. Shkreb and K. Khvedchuk (2016) and O. Zholud and I. Piontkivska (2016).

2.2.6. MONETARY SECTOR AND FINANCIAL MARKETS[44]

In Q2 2017, after pausing for almost half a year, the National Bank of Ukraine (NBU) resumed easing monetary policy. In April-May, the NBU Board reduced the key policy rate twice, by 150 bp in total to 12.5% per annum. This gradually reduced interest rates on interbank hryvnia loans, as well as the weighted average interest rates on loans (excluding overdrafts) and the deposits of non-financial corporations and households.

The FX market remained favorable in Q2 2017, which, together with reasonably balanced inflation risks, allowed the NBU to further relax administrative restrictions on the FX market.

Based on data from April-May 2017, bank deposits continued growing gradually. Hryvnia household deposits increased rapidly. Corporate deposits grew slower due to large quarterly tax payments and increased working capital requirements (including cash).

Lending remained sluggish on the back of persistently high credit risk and the heavy debt burden of corporate borrowers. At the same time, consumer lending to households continued picking up thanks to improving consumer confidence and rising demand for durable goods.

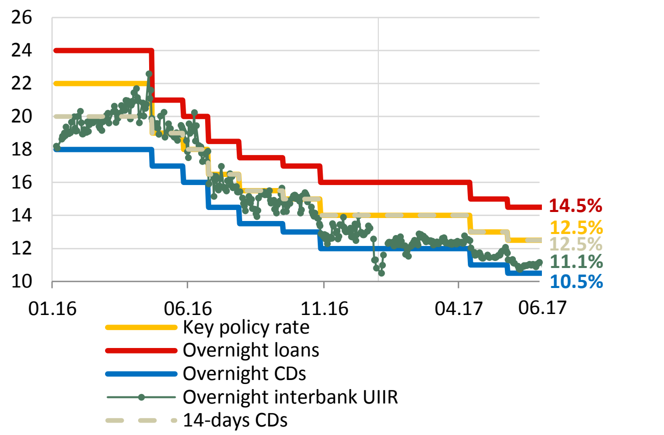
Interest Rates

The resumption of monetary policy easing in mid-April 2017 (after pausing for almost half a year) pushed interbank interest rates further downward for hryvnia funds in Q2. Compared with Q1 2017, the weighted average interbank lending rate declined 74 bp to 12.2% per annum in April-May.

The cost of other hryvnia funds declined as well. In Q2 2017, yields on hryvnia domestic government bonds for all maturities decreased both on the primary and secondary markets. High demand for medium-term hryvnia securities was backed by the banking system’s excess liquidity and market expectations of further moderate monetary policy easing. In May, for the first time since early 2017, the Ministry of Finance of Ukraine (MFU) offered USD bonds. The bonds carried a maturity of three years (three-year FX-denominated domestic government bonds were last placed in 2013), but they only saw limited demand.

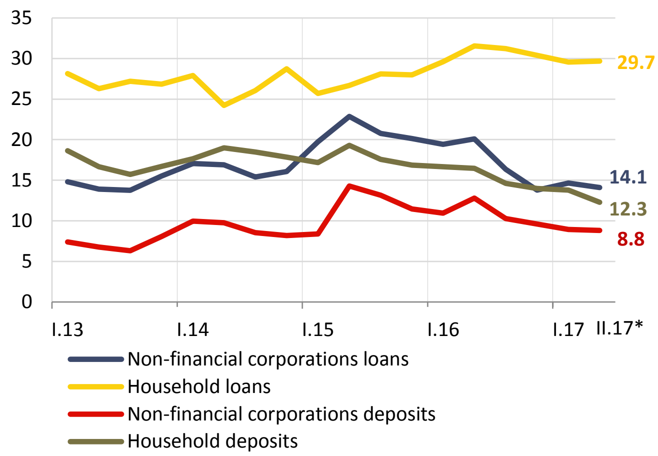
Banks’ retail interest rates for hryvnia funds decreased in April-May 2017. Although demand for funds from non-financial corporations was high, increased competition between banks was a key factor that lowered the weighted average interest rates on loans (excluding overdrafts) for non-financial corporations. At the same time, interest rates for household loans remained steady at the level of the previous quarter. Interest rates for household loans have remained high because short-term consumer loans and

NBU Policy Rates and Ukrainian Index of Interbank Rates, % pa



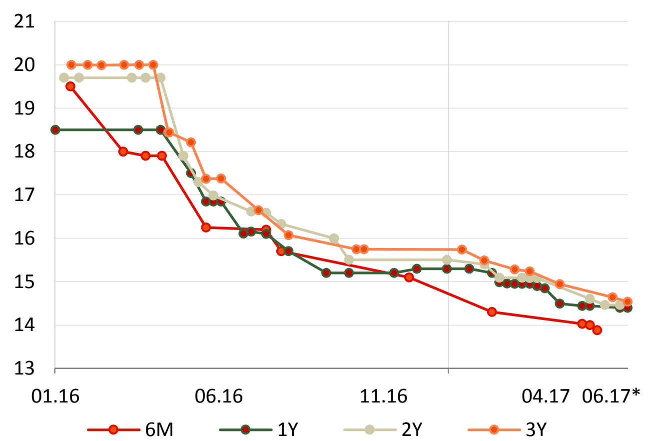
Source: NBU

Average Weighted IR on New Hryvnia Loans (excl. overdrafts) and Deposits, % pa



* April-May 2017
Source: NBU

Term Structure of Hryvnia Yields on Primary Market, % pa



**One-year securities include bonds maturing in 11 months*
Source: NBU

[44] The information provided is based on real-time data.

credit cards hold a large share of loans and those facilities carry relatively higher servicing costs.

Despite an overall gradual decrease in hryvnia deposit interest rates, the trends varied by maturities. The cost of household deposits with maturities ranging from overnight to one month grew slightly in April-May, although term deposit rates continued declining, especially for deposits with maturities longer than 2 years. On the other hand, deposit rates on the funds of non-financial corporations moved in the opposite direction – to compete for clients and to improve their funding, banks raised interest rates for deposits of longer than six months and reduced rates for deposits with other maturities.

The Foreign Exchange Market

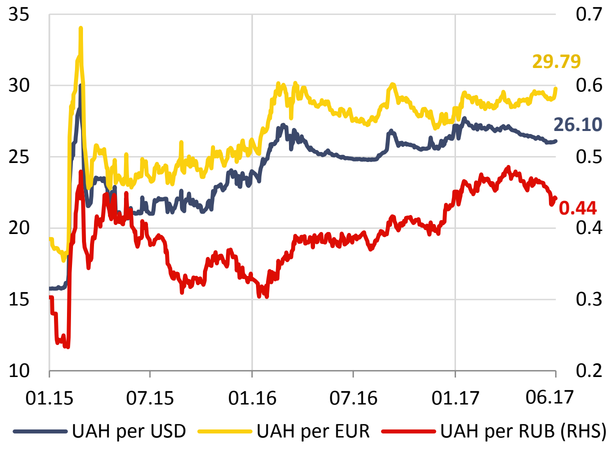
In Q2 2017, FX market conditions remained favorable as the hryvnia appreciated against the USD. The appreciation was driven by an increased FX supply (as the amount of foreign currency received from non-residents exceeded FX outflows) and significant volumes of FX cash sold by households. At the same time, demand for FX remained at the same level as in the previous quarter. The appreciation of the UAH/USD exchange rate was also driven by the depreciation of the USD against major currencies.

Given the favorable environment, in Q2 2017 the NBU mostly purchased FX to replenish international reserves without counteracting FX market trends . Over Q2 2017, the weighted average official UAH/USD exchange rate decreased 2.2%, while FX purchases by the NBU netted to USD 1.2 billion (USD 1.4 billion since the start of the year).

At the same time, the hryvnia NEER remained practically unchanged in Q2 as the currencies of most of Ukraine's major trading partners (MTPs) also strengthened against the USD. The REER rose slightly as Ukraine's inflation still exceeds inflation across the country's MTPs. In annual terms, the hryvnia's REER grew 4.7%.

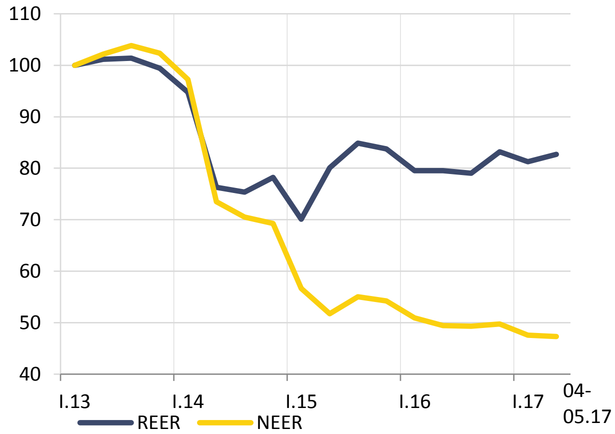
The stabilization of exchange rate expectations on the back of the hryvnia's appreciation against the USD has boosted the supply of FX cash by households. Moreover, official FX cash market operations were encouraged by the NBU's measures from the start of the year to gradually liberalize currency controls as well as by the cancellation of the pension fee on purchasing FX cash. In Q2 2017, households sold on average USD 38 million in FX cash per day, almost double that of Q2 2016.

The Official Hryvnia Exchange Rate



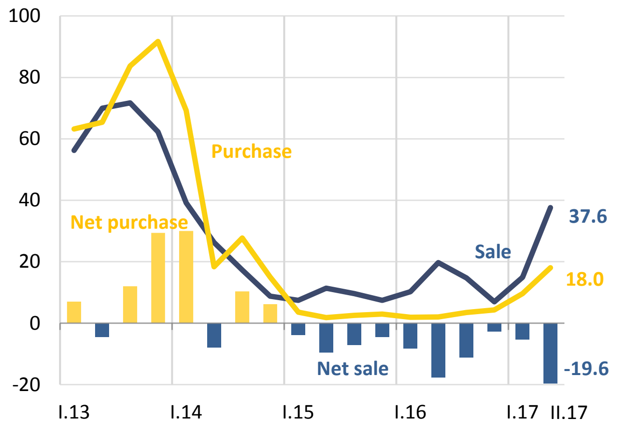
Source: NBU

Hryvnia REER and NEER Indices* (Based on Interbank Exchange Rate, I.2013=100, average)



Source: NBU

Daily Average Amount of Cash FX Purchased/Sold by Households, USD mn



Source: NBU

Box: The NBU's Measures to Liberalize the FX Market and Improve the Functioning of Financial Markets

The favorable FX market situation and reasonably balanced inflation risks allowed the NBU to continue easing administrative FX restrictions in Q2 2017. The NBU:

– Eliminated the temporary limit on the maximum settlement term for exports/imports of goods. Based on the relevant law, the term currently stands at 180 days

– Allowed foreign investors to buy FX to transfer abroad funds sourced from the sale of corporate rights and certain types of securities, from a decrease of authorized capital, or from the divestiture of a company

– Allowed the early repayment of external loans and borrowings by businesses, if those facilities are secured with liabilities from international financial organizations

– Allowed banks to open correspondent accounts in FX of the first group of the Classifier of Foreign Currencies and Banking Metals with non-resident banks whose domestic currencies belong to other classifier groups

– Lifted the ban on purchasing foreign currency to repay liabilities when a client's account contains own funds in excess of USD 100,000

– Eliminated the limit (UAH 100,000 per month) on the amount of money individuals can transfer abroad for non-trade transactions

– Eliminated the requirement for banks to perform FX operations on both the interbank and international FX markets within one classifier group

– Facilitated forward FX transactions by eliminating the limit on the Foreign Currency Classifier group, term, and type of hedged transaction for banks' own FX transactions as well as for importer/exporter FX operations (currency conversion) and operations to buy/sell FX for hryvnia to hedge exchange rate risks

– Expanded the list of operations banks are authorized to perform with investment metals by canceling the restriction for investment metals to be bought/sold (under TOD, TOM, spot, forward, and swap terms) on the interbank FX market for hryvnia only and on the interbank FX market only for FX that belong to the 1st classifier group

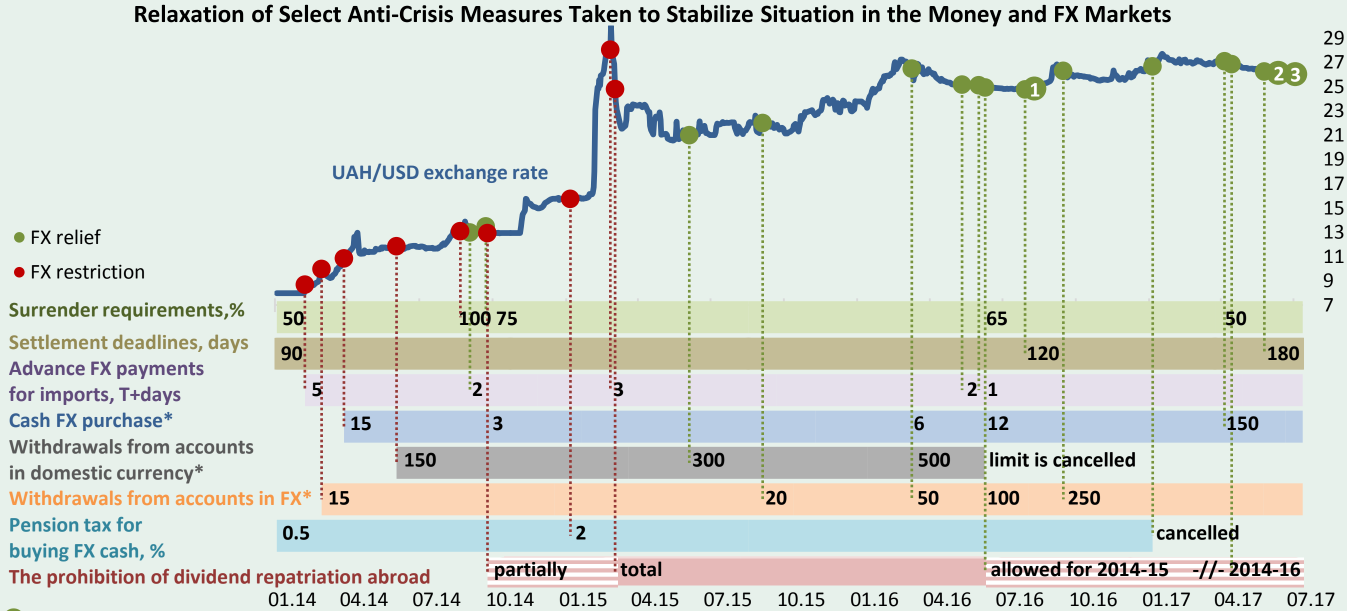
– Removed the restriction for the classifier group and the number of exchange operations using FX on the accounts of non-entrepreneur individuals and allowed individuals to convert FX cash into cashless form without any limitations on the classifier group

– Introduced individual electronic licenses for individuals. The licenses allow the FX transfer abroad for investments, to hold funds on own accounts, and to fulfill life insurance obligations towards non-residents of up to USD 50,000 (currency equivalent) over the course of one year

– Raised the limit for businesses to invest abroad per license from USD 50,000 per calendar month to USD 2 million per calendar year and differentiated the requirements to obtain a license by simplifying the procedure for investments under USD 50,000 and requiring full documentation for amounts over USD 50,000.

Aside from liberalizing FX restrictions, the NBU implemented measures to prevent capital outflows by introducing requirements to disclose information about the ultimate beneficial owners (UBO) of non-resident creditors. The regulator also improved controls over adherence to the maximum contractual interest rate if commissions and charges are paid prior to the disbursement of a loan and/or during the first year of contract.

Relaxation of Select Anti-Crisis Measures Taken to Stabilize Situation in the Money and FX Markets



1 Cancellation of ID request for FX transactions (up to 150 000 UAH)

2 Lift of select restrictions on: (I) repatriation of funds invested in Ukraine and (ii) transfers abroad by individuals related to non-commercial operations. (iii) Increase of annual limit for investing abroad from 0.6 to 2.0 bn USD.

3 Launching E-licenses for FX transfers abroad by individuals

* measured in thousand UAH

Base Money and Liquidity

In April-May 2017, bank liquidity remained high and continued growing moderately. This was mainly reflected in an increase in the average daily stocks of the CDs (5.7%), while the growth of average daily stocks on banks' correspondent accounts slowed from Q1 2017 to 0.8%.

Liquidity in the banking system was mostly injected through the NBU's purchases of FX to replenish international reserves. The NBU purchased net UAH 24.5 billion, more than seven times higher than in Q1 2017.

Liquidity was mainly absorbed by government transactions, the impact of which substantially increased in May due to quarterly taxes and other payments, as well as seasonal growth in cash. The net impact of these transactions is estimated at UAH 12.5 billion[45] and UAH 11.4 billion respectively. In addition, liquidity in the banking system decreased as banks repaid loans from the NBU, with lending operations with banks netting to UAH -3.1 billion. However, the Deposit Guarantee Fund's (DGF) operations did not have a significant impact on liquidity.

The monetary base increased by 3.2% in May from Q1 2017 levels, with the annual growth rate unchanged (9.1%) as cash increased at the end of May and the stock of banks' correspondent accounts remained flat with the levels of March.

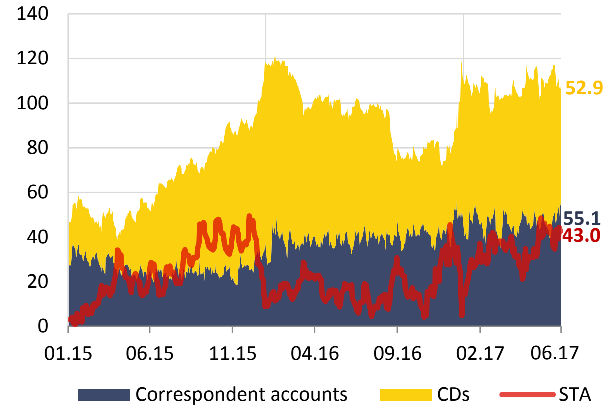
The Money Supply and Its Components

In April-May 2017, the stock of corporate and household deposits grew in hryvnia and in FX (in USD equivalent). Over April-May, household hryvnia deposits increased 3.8% from Q1 2017 and 12.2% yoy. This was driven by wage increases, the retained attractiveness of bank deposits on the back of expectations of a further decrease in deposit rates, and a steady decrease of the UAH/USD exchange rate. Over this period, the stock of non-financial corporations' hryvnia deposits grew as little as 0.4% (9.1% yoy). Large quarterly tax payments, increased working capital requirements (including cash), and high leverage contributed to the slower growth of corporate deposits.

Deposits with maturity between 1 and 2 years grew the fastest as banks kept the pricing attractive to clients as a means of attracting medium-term funding.

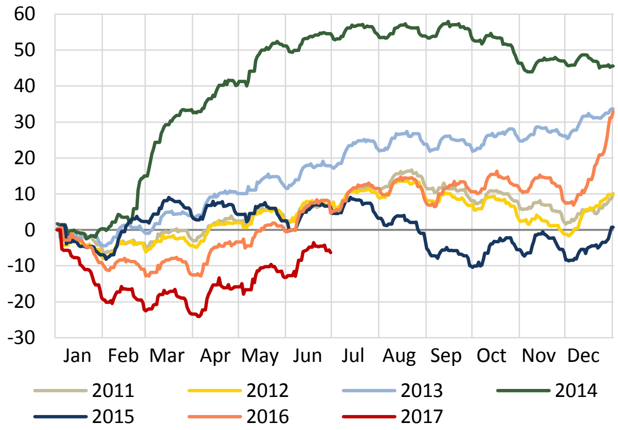
In addition, FX bank deposits grew (in USD equivalent) in April-May. This was primarily driven by confiscated funds transferred to the budget in April, which led to a sharp increase (by more than five times) in the account balances of central public administration bodies (earlier, those funds had been kept on the accounts of non-residents and therefore excluded from monetary indicators). The stock of deposits of non-financial corporations also continued

Select Indicators of Banking System Liquidity, UAH bn



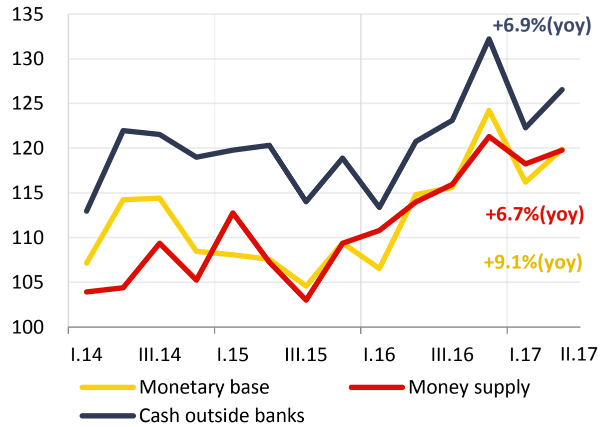
Source: NBU

Cash in Circulation, UAH bn ytd



Source: NBU

Monetary Indicators, 12.2013=100



Source: NBU

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[45]The impact of fiscal factors on growth in banking system liquidity was calculated based on changes in the single treasury account (STA) balances (up by UAH 11.1 billion), redemptions of government securities by the government that were held in the NBU portfolio (UAH 16.9 billion), transfer of the NBU's profit to the budget (UAH 15.0 billion), FX sales by the government to the NBU (UAH 0.2 billion), and the transfer of funds by the government to the DGF and bank liquidators (UAH 0.3 billion).

growing – mainly on the back of large volumes of FX revenues.

Those deposit trends, coupled with an increase in cash outside banks increased the monetary base 1.3% in April-May, although annual growth rates remained flat at March levels (6.7%). Growth was partially held back by the exchange rate revaluation of FX deposits as they decreased after the hryvnia appreciated against the USD.

Loans

In April-May 2017, banks' lending activity remained sluggish on the back of persistently high credit risk and the high debt of corporate borrowers. In addition, banks' strict internal requirements for collateral, loan maturities, and loan size also restrained growth in credit portfolios. Overall, the annual growth rates of total outstanding hryvnia loans accelerated slightly to 18.4% as of the end of May from 17.1% at the end of March.

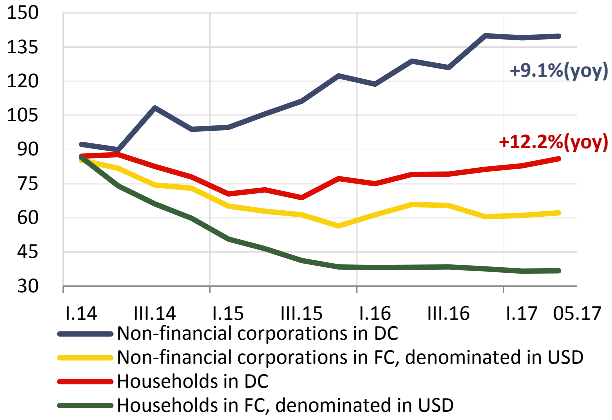
The annual growth rates of outstanding household loans increased to 5.4% as consumer lending increased. Lending grew especially for automobile purchases and other consumer needs. This could be driven by the rapid growth in wages, which likely improved borrower solvency indicators and enabled an increase in credit card limits. Accelerated growth of overdraft loans was the evidence of such increase. The improvement in consumer confidence and higher spending on durable goods may have also contributed to the revival of consumer lending.

On the other hand, the stock of loans to non-financial corporations decreased slightly over April-May, driven by a significant decrease in loans with maturity of between one and five years; other maturities increased. Accordingly, the annual growth rate also decelerated slightly to 23.7%. **Outstanding loan amounts declined in the processing and construction industries, while loans to agriculture, forestry, and fishery continued to rise.**

FX lending (in USD equivalent) continued decreasing for both households and the corporate sector.

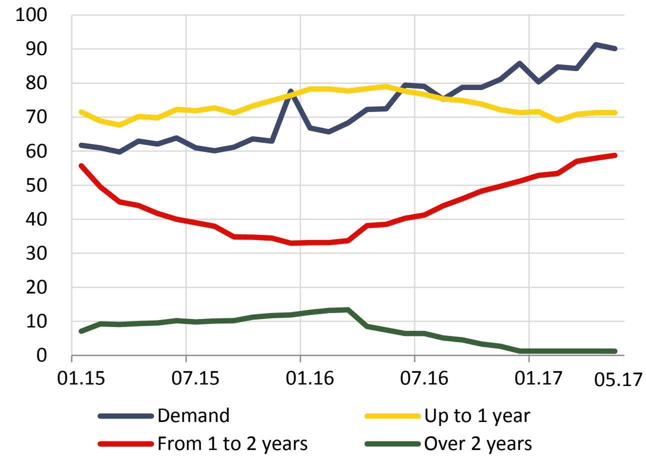
Nevertheless, bank lending is expected to recover. According to the results of the Q2 2017 *Lending Survey*, in Q1 2017 respondents forecasted a revival of consumer and corporate lending within the following 12 months and an improvement of credit portfolio quality on both the corporate and retail sides.

Deposits, IV.2013=100



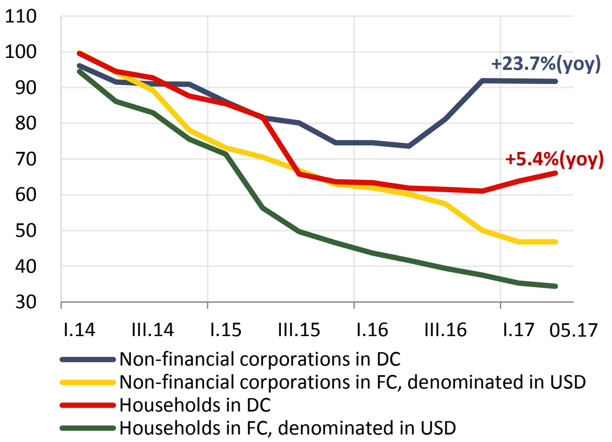
Source: NBU

Maturity of Domestic Currency Household Deposits, UAH billion



Source: NBU

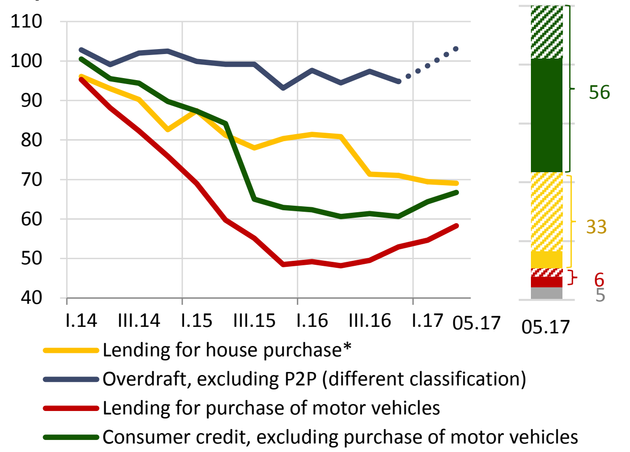
Loans, IV.2013=100



Source: NBU

Select Indicators of Households Lending in Hryvnia, IV.2013=100

Structure of Outstanding Amounts of Loans to Households, %**



* Include lending for real estate purchase, its development or reconstruction

** Solid area stands for relative share of loans in hryvnia, while shaded – foreign currency. Gray area denotes other loans in all currencies

Source: NBU

Box: The NBU's Monetary Policy in Conditions of a Structural Surplus of Bank Liquidity

Most leading central banks long ago made a decision between controlling the supply of money or controlling its cost (interest rate) as the best way to achieve price stability. Managing of money supply (or monetary targeting) is no longer the preferred approach to monetary policy. The theory behind monetary targeting is simple and easy to use. However, the actual practice of many central banks has proven that this regime is not preferable for monetary policy because demand for money cannot be forecasted. Therefore, a central bank cannot reliably assess the optimal quantity of money needed and thus, the influence its own policy has on inflation.

Using interest rates as a monetary policy tool/target is an alternative way of controlling the money supply. This method has advantages over monetary aggregates; it allows the central bank to:

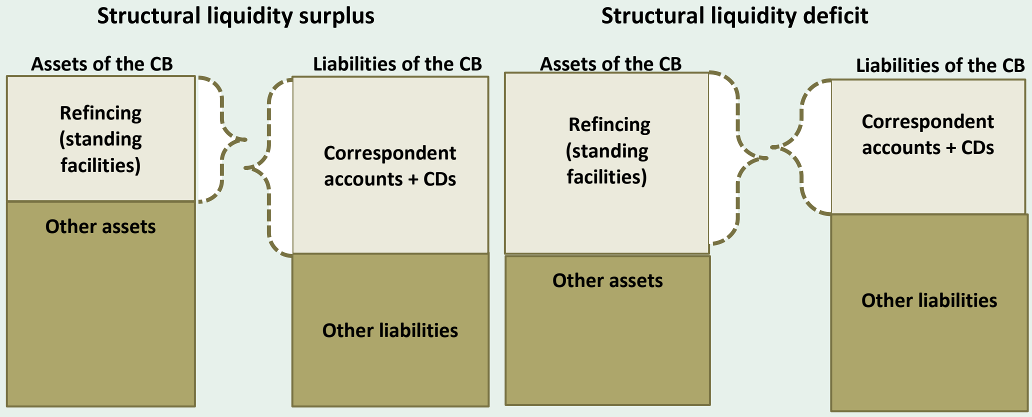
- Assess the influence its own policy has on inflation using models based on modern economic theory
- Clearly communicate its decisions regarding the monetary policy stance: by reducing the interest rate to ease monetary policy and vice versa.

When using the interest rate as a monetary policy tool and target, the central bank enacts monetary policy by influencing short-term interest rates on the interbank lending market. This is achieved by changing the interest rate for the central bank's main operations – to inject or absorb (sterilize) liquidity. Bank liquidity implies banks' funds held on correspondent accounts at the central bank (the central bank's liabilities to banks). The type of operations used (injection or absorption) depends on the structural liquidity position of the banking system: deficit or surplus.

With a structural surplus of bank liquidity, the central bank acts as a net debtor in relation to commercial banks – its short-term liabilities towards banks exceed short-term liabilities banks owe to the central bank. In the case of a structural deficit of liquidity, the central bank becomes a net creditor of the banking system – banks' short-term liabilities towards the central bank exceed short-term liabilities of the central bank towards banks. This means banks are not able to settle their debt in full to the central bank even if they deplete their correspondent accounts with the central bank.

To manage interbank interest rates, the central bank absorbs (sterilizes) excess liquidity amid a liquidity surplus and supports liquidity by lending during structural deficits. In both cases, the central bank aims to keep the short-term interest rate on the interbank lending market within a defined interest rate fluctuation band and close to the key monetary policy rate.

By itself, the simple observation of liquidity absorptions or injections as the prevailing operation of the central bank does not define monetary policy as loose or tight. The only important characteristic is the interest rate for those operations; the interest rate influences the banking system and the economy.



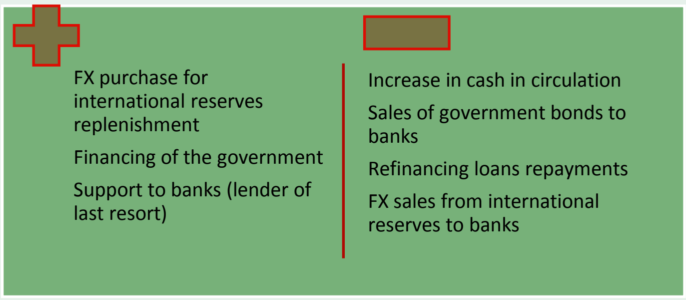
For example, sterilization under conditions of structural liquidity surplus is not aimed at limiting banks' access to liquid funds. The goal is to influence the cost of money for banks. In particular, the central bank can sterilize liquidity by issuing certificates of deposit, as the NBU does. However, certificates of deposit are highly liquid instruments that do not limit banks' operations. First, they have a short maturity (only overnight or two weeks in the case of NBU certificates). Second, a bank can easily sell them to another bank. Third, a bank can provide certificates of deposit as collateral for loans received from the central bank or another bank.

Similarly, the central bank's refinancing operations for commercial banks do not aim to inject money into the lenders themselves. The central bank seeks to capitalize on banks' demand for funds to influence interest rate dynamics.

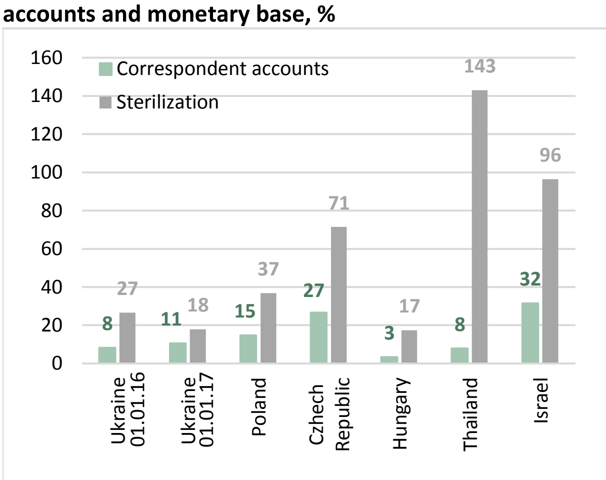
What are the causes of a structural deficit or surplus? The liquidity of the banking system can increase or decrease solely because of operations conducted between a central bank and commercial banks. For example, a structural deficit can appear when banks exchange funds deposited in correspondent accounts with the central bank for cash from its vaults, with their subsequent disbursement for client needs. Over time, nominal demand for cash rises, prompting banks to borrow more from the central bank in exchange for cash. In the period prior to the 2008 global crisis, most developed countries experienced this type of structural deficit. Later, the deficits turned to surpluses as those central banks embarked on asset purchase programs known as quantitative easing.

A surplus of liquidity can appear when a central bank purchases foreign currency to replenish international reserves. For this reason, liquidity surpluses are common for emerging markets.

Ukraine's banking system currently has a liquidity surplus, although it is smaller than in other emerging markets.



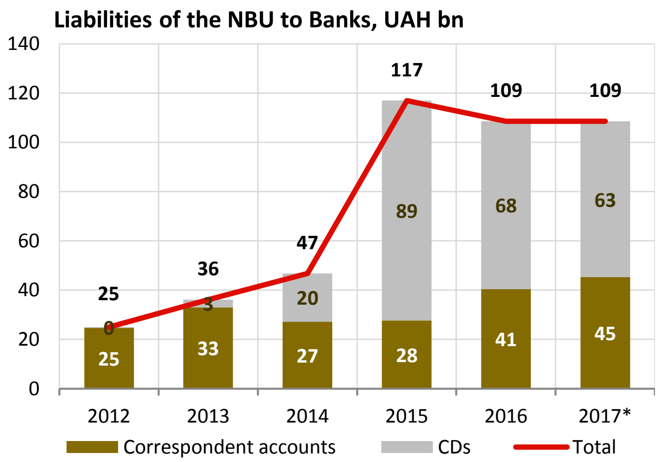
The stock of sterilization instruments to correspondent accounts and monetary base, %



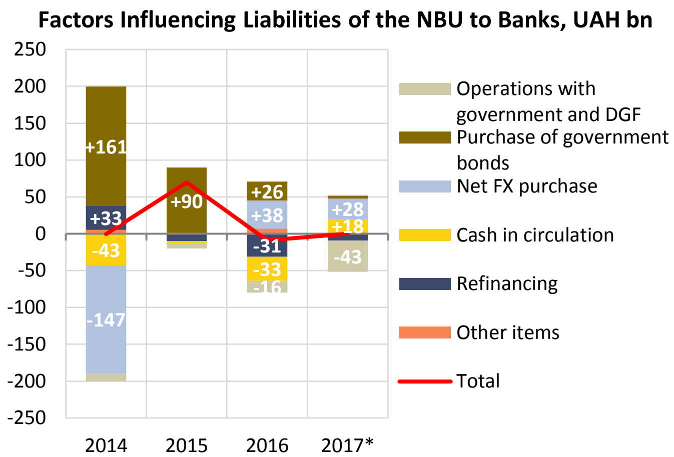
The surplus in Ukraine's banking system was formed by different factors. In the crisis of 2014-2015, a surplus emerged through the NBU's operations to purchase government securities and support the banking system. Those operations were prompted by the needs of the state (especially to shore up Naftogaz) and to ensure financial stability (to finance the Deposit Guarantee Fund) during the crisis. With the reform of the energy sector, Naftogaz no longer needed state support, while the economic recovery and the banking system's improved health reduced the need for the NBU to support banks and the Deposit Guarantee Fund.

Funds issued earlier have been withdrawn through the same channels, namely through redemptions of government securities by the government that were held in the NBU portfolio. Starting in 2016, the NBU's foreign currency purchases to build up international reserves have been the key driver of the emergence of the surplus.

Given a structural surplus of bank liquidity, the NBU's 14-day deposit-taking operations comprise the regulator's main monetary policy operations. The interest rate on 14-day CDs is equal to the key policy rate. The NBU's CDs are used as a tool to influence the cost of money rather than limit its supply. Therefore, changes in the key policy rate (and, consequently, the 14-day CD interest rate) normally feed into interbank interest rates. As a result, short-term interest rates stay within the defined interest rate band (for reference, see the chart NBU Policy Rates and the Ukrainian Index of Interbank Rates on page 39). This is a clear sign that the first link of the transmission mechanism of monetary policy is working well after its operational framework was redesigned in mid-2015.



* As the end of May
Source: NBU



* January-May
Source: NBU

3. THE ECONOMIC OUTLOOK FOR UKRAINE

3.1. FORECAST ASSUMPTIONS

Economic growth in Ukraine's MTPs is projected to accelerate in 2017-2019, buoyed by the recovery in consumption and investment demand against the backdrop of favorable financial conditions and a rebound in global trade. The economies of developed countries and emerging markets are expected to grow rapidly. However, geopolitical developments, particularly rising tensions in the Middle East and in Eastern Ukraine, will weigh on economic prospects.

We expect the following:

– US GDP growth will accelerate, supported by stronger domestic demand against a stable unemployment rate, lower tax burden, and revival of infrastructure projects. The US Federal Reserve is likely to gradually raise rates as it unwinds its balance sheet.

– Euro area economies are expected to outpace potential growth rates, bolstered by a cyclical recovery in industrial production, moderately expansionary fiscal policy, and accommodative monetary policy by the ECB over the forecast horizon. At the same time, growing uncertainty in the Brexit negotiations is looming over the EU's economic outlook, amplified by the heavy debt burden in the public and private sector amid high levels of non-performing loans, demographic trends, and political risks

– The economies of Central and Eastern European (CEE) will grow steadily thanks to rising domestic demand stemming from an increase in employment and wages, as well as heightened interest in those countries' financial assets, which remain immune to the situation in the euro area. Additionally, economic growth will be reinforced by exports thanks to steady demand from MTPs (particularly EU members). However, a decline in financing from EU development funds will impact CEE countries

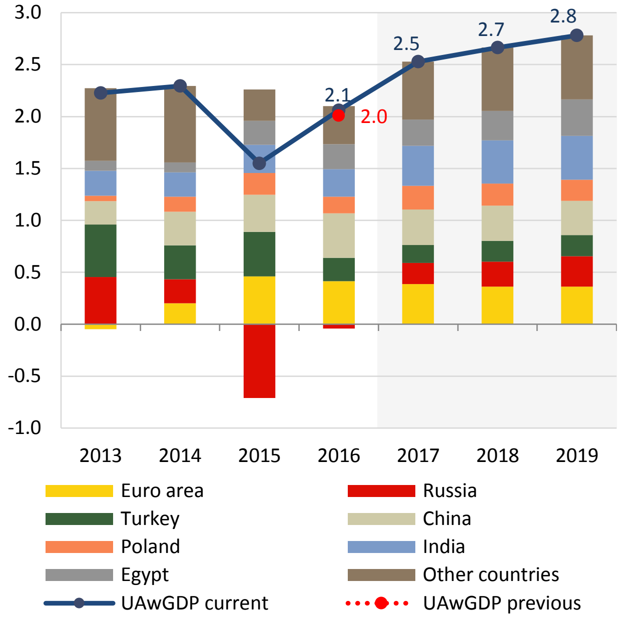
– China's economic growth will decelerate, but the rate of growth will remain among the highest in the world. The recovery of global commodity markets along with strong public investment in infrastructure and production-related projects will further support the Chinese economy. On the other hand, economic growth will be held back by high corporate debt, capital outflows, and the impact of anti-dumping measures against Chinese producers.

– Stronger global markets will drive Turkey's economic growth, but political instability and sluggish domestic demand will remain major drags on the pace of growth.

– Egypt's economic growth will gradually accelerate thanks to measures taken under an IMF program and stronger demand from the country's main trading partners, especially the euro area, China, the US, and the Russian Federation

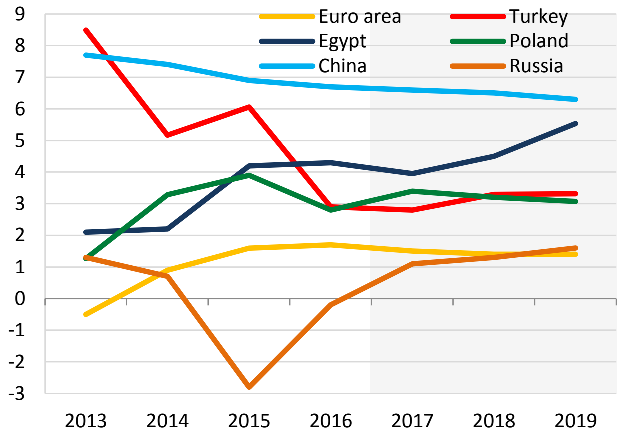
– The economic recovery in Russia will continue as prices for oil and ferrous metals stabilize, domestic demand picks up as inflationary pressures retreat, and real household incomes rise. These trends will also benefit neighboring countries, including Kazakhstan and Belarus.

Contributions of Ukraine's MTP Countries to the Annual Change of UAwGDP, % yoy



Source: NBU staff estimates (preliminary data) based on IMF

Real GDP of several Ukraine's MTP Countries, % yoy



Source: NBU staff estimates, based on IMF

For Ukrainian exporters, prices on global markets will remain close to current levels, with some upside expected in 2018-2019.

Despite possible adjustments, prices for ferrous metals are expected to remain high on the back of stronger demand and anti-dumping duties introduced by some countries. According to the World Steel Association's estimates, steel product consumption will increase 1.7% in 2017 to 1,535 billion tons and a further 0.9% in 2018. Stronger steel demand in emerging markets will offset its decline in advanced economies. The introduction of new technologies in those countries has also served to discourage steel consumption. In particular, the automobile industry is increasing its use of lightweight high-strength steel. In addition, the lifespan of metal products has also increased thanks to recycling, which decreases the use of additional steel.

High production volumes will create downward pressure on iron ore prices. By lowering production costs, the world's global producers (BHP Billiton, Fortescue Metals Group, and Rio Tinto) will be able to remain cost-effective even if prices decline to USD 40/ton. The same is true for Brazil's Vale, in spite of its higher transportation costs to China. However, higher demand for high-grade ore, primarily from China, and an increase in steel production in India and China will help counteract a steep drop in prices.

Global grain prices will recover gradually as production slows and consumption remains steady. Global grain production is projected to decrease 3.2% yoy to 2,053 million tons in the 2017/2018 marketing year. Wheat yields are projected to decline 2.4%, corn yields – 3.7%[46]. Corn production is expected to decline in the US as the country partially shifts to soy production, a more profitable crop. This will contribute to the deeper decline in corn yields than on grain. High inventories will only partially offset the decreased harvest.

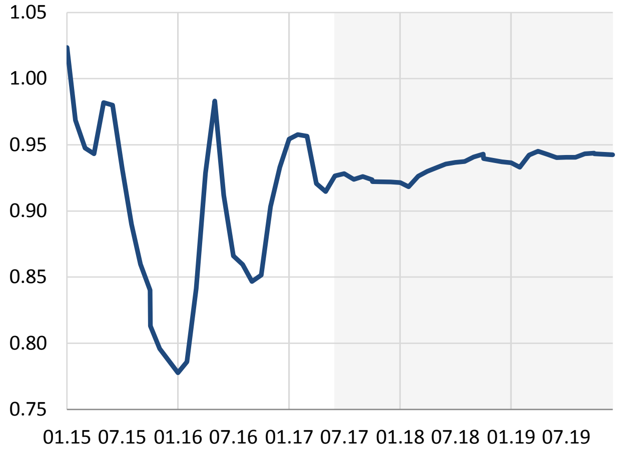
Total grain consumption will remain level with the previous marketing year at 2,086 million tons, but some grades of grain will enjoy higher demand. Demand for grain is projected to grow 2.5% (driven largely by demand from countries of North Africa).

Global oil markets are expected to gradually rise. Price growth will be supported by a deal among major oil producing countries (OPEC +) to freeze production volumes. However, against the backdrop of rising global demand, expectations for a full implementation of the deal are somewhat pessimistic. Asian buyers (primarily China and India) will drive up demand for light low-sulfur crude oil extracted from US-based shale deposits. The stronger US demand will be driven by a revival of business activity. Prices may also rise due to potential disruptions in supply from Middle East countries amid political turmoil.

However, excessive growth in oil prices will be constrained by:

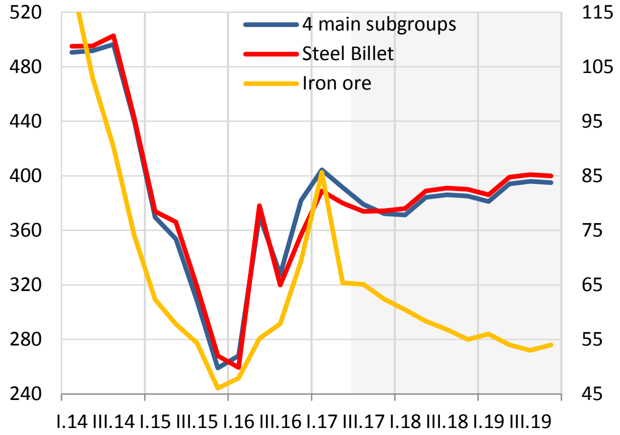
– A surge in US crude output, particularly shale oil, as production costs have been decreasing thanks to state-of-the-art technologies and a larger geographical dispersion of

External Commodity Price Index (ECPI), 12.2004=1



Source: NBU staff estimates

Estimated world price of ferrous metals and Iron Ore Prices*, USD/MT, quarterly average

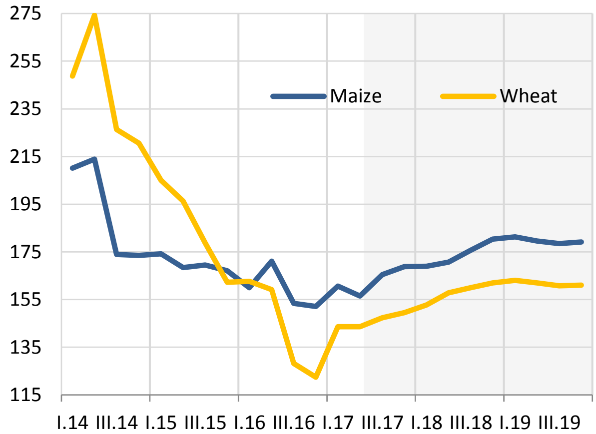


* Steel Billet Exp FOB Ukraine

* China import Iron Ore Fines 62% FE spot (CFR Tianjin port)

Source: NBU staff estimates, based on Metal Expert

World Cereal Prices, USD/MT, quarterly average



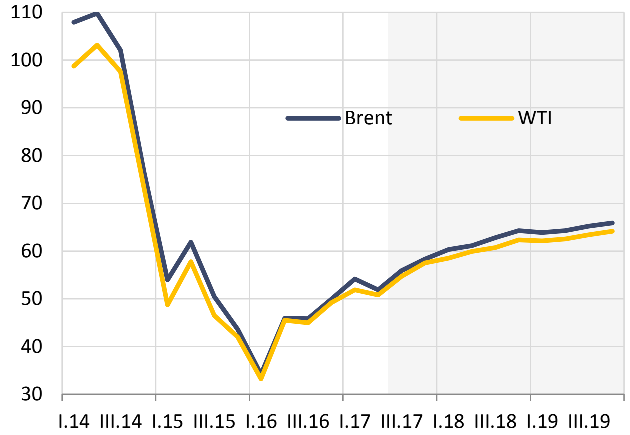
Source: NBU staff estimates

[46] According to estimates by the International Grain Council from 25 May 2017.

shale extraction after the US withdrew from the Paris climate accord, which restricted gas emissions

– The plans of some OPEC countries (Iraq, Iran, and Libya) to ramp up oil production and exports using accumulated reserves.

Brent and WTI Crude Oil Prices, USD/bbl, quarterly average



Source: NBU staff estimates

	CPI, change as of the end of period, %			GDP, annual change, %			Exchange rates*		Commodity Prices**, USD			
	Euro area	Russia	USA	Euro area	Euro area	Russia	USA	Euro area	Euro area	Russia	USA	Euro area
2014	-0.2	11.4	0.8	0.9	0.7	2.4	1.33	38.3	292.5	99.1	481.5	201.2
2015	0.2	12.9	0.7	1.6	-2.8	2.6	1.11	61.0	274.0	52.5	336.1	166.9
2016	1.1	5.4	2.1	1.7	-0.2	1.6	1.11	67.1	200.9	43.9	299.4	153.4
2017	1.4	4.0	2.0	1.5	1.1	2.3	1.09	58.0	235.8	55.1	371.6	158.0
2018	1.4	4.0	2.0	1.4	1.3	2.4	1.11	58.1	272.7	62.1	365.1	164.9
2019	1.6	4.0	2.0	1.4	1.6	2.2	1.11	58.1	291.6	64.8	376.8	166.0
annual change, *%*												
2015							*-16.5*	*59.3*	*-6.3*	*-47.0*	*-30.2*	*-17.1*
2016							*0.0*	*10.0*	*-26.7*	*-16.4*	*-10.9*	*-8.0*
2017							*-1.8*	*-13.6*	*17.4*	*25.5*	*24.1*	*3.0*
2018							*1.1*	*0.2*	*15.7*	*12.7*	*-1.8*	*4.4*
2019							*0.0*	*0.0*	*6.9*	*4.3*	*3.2*	*0.7*

** Average for the year.*

*** Average weighted by volume, excluding oil.*

3.2. PRICES

Headline inflation will continue to fall over the forecast period and remain within the announced target range: 8% ± 2 pp in 2017, 6% ± 2 pp in 2018, and 5% ± 1 pp in 2019. As projected previously, inflation will only deviate from the mid-point of the target range this year, coming in at a projected 9.1% by the end of 2017, mainly due to growth in domestic demand and higher production costs prompted by the doubling of minimum wages in early 2017 and the impact of food supply-side factors.

This will put additional pressure on the main inflation components throughout this year: core inflation will edge up to 6.1%, while raw food inflation is projected to rise to 11.8%. Growing prices for meat and dairy products on global markets and increasing exports of Ukrainian food products, which is limiting domestic supply, will drive the spike in food prices.

Among inflation components, administered prices are projected to grow at the highest pace (over 10%), mainly on a recovery of global energy prices and Ukraine's excise policy.

Over the medium term, prudent fiscal and monetary policies will help keep inflation within the target range. In these circumstances, core and food inflation components will stay below 4% (provided there are no significant supply shocks).

Core inflation is expected to accelerate slightly to 6.1% this year (from 5.8% last year) mostly due to the impact of rising personal incomes and production costs following the government's decision to increase minimum wages at the start of the year. That increase in H1 has largely boosted prices for services, which are included in core CPI. Prices for processed foods will also grow due to secondary effects from higher raw food prices.

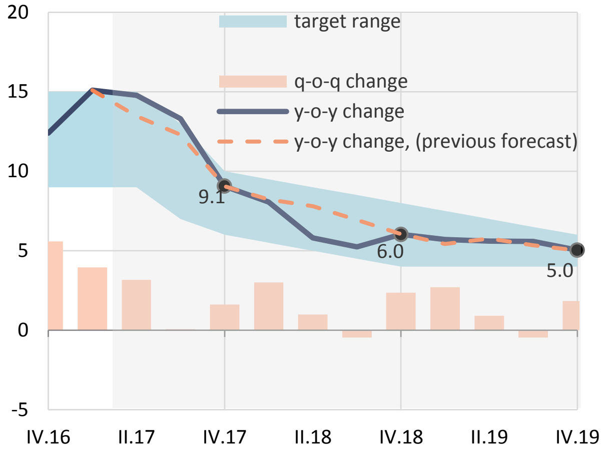
At the same time, low FX rate volatility and lower imported inflation, an above-equilibrium unemployment level, a moderate monetary policy, and the sustained negative GDP gap will help curb core inflation.

Core inflation is expected to decrease to 3.9% in 2018 and to around 3.0% in 2019. Imported inflation is projected to remain low over the forecast horizon thanks to a low-inflation environment in Ukraine's main trading partners.

Raw food inflation will accelerate to 11.8% this year, driven by growing food product exports (especially meat and dairy) and decreased domestic supplies, which, in turn, creates pressure on prices. The harsh weather of this past spring is also contributing to the current spike in food prices, particularly against a less bright outlook for the fruit and vegetable harvest.

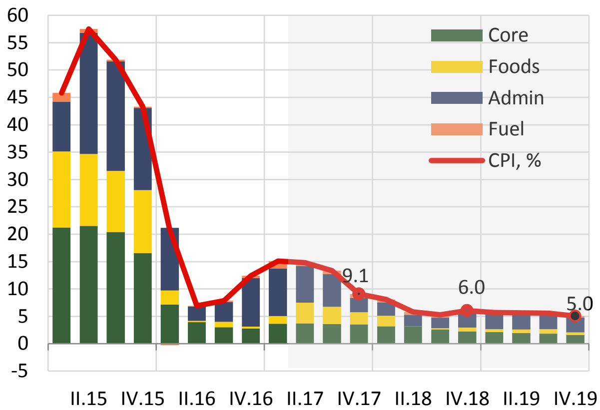
Apart from supply-side factors, demand-pull inflation will be driven by the recovery of consumer demand as a result of rising real incomes.

CPI, %



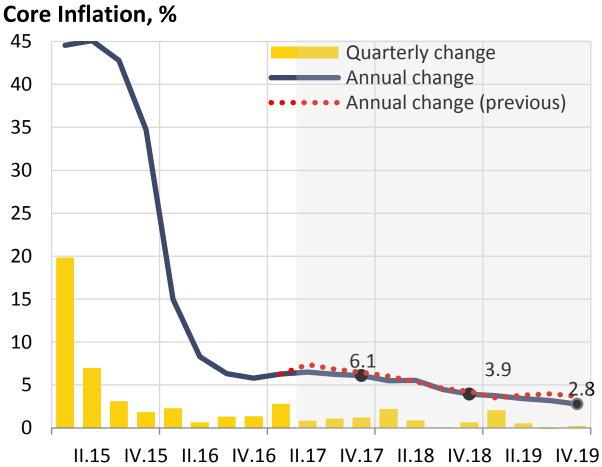
Source: SSSU, NBU staff estimates

Contribution to Annual Growth of CPI, p.p.



Source: SSSU, NBU staff estimates

Core Inflation, %



Source: SSSU, NBU staff estimates

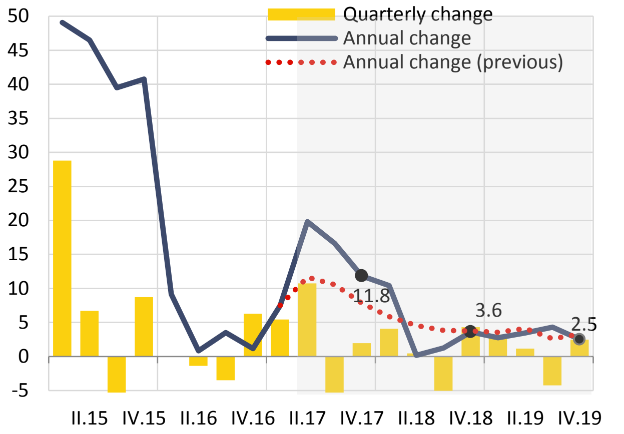
In 2018-2019, raw food inflation is expected to stay close to 4% as household incomes will continue to grow (with no significant supply shocks, including on global markets). At the same time, high crop yields as a result of agricultural investments and growing productivity are expected to rein in food inflation over the mid-term.

Administered prices are projected to continue rising rapidly over the forecast horizon, but growth will gradually slow down (13.8% in 2017, 12.3% in 2018, and 11.5% in 2019). Those increases will be largely driven by the anticipated increase in imported energy costs, with a direct impact on prices for gas, central heating, and hot water for households. The previous forecast for growth in the natural gas price for households in H2 2017 was adjusted as information outlining the expected increase was not published in time (per regulations, any changes in import-parity prices for gas that would take effect from 1 October must be announced by 1 July). The gas price is a major price component in calculating rates for central heating and hot water.

Among goods subject to excise tax, the highest increase this year will be in prices for tobacco products, up 20%. Excise tax rates are expected to also continue growing in the coming years (particularly to meet Ukraine's commitments to harmonize tobacco excise taxes with EU rates), which will result in 10%-13% increases for tobacco and alcohol prices.

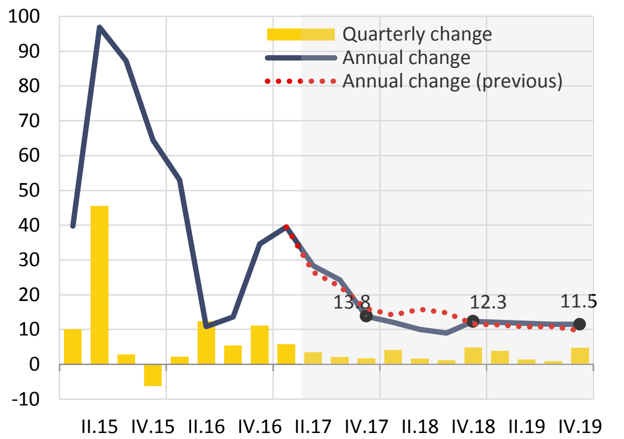
Fuel prices are projected to grow 13% in 2017 on the back of higher global crude oil prices. Looking ahead, fuel prices will also move in line with the hryvnia-denominated global oil price and reflect changes in Ukraine's tax policy.

Raw Food Inflation, %



Source: SSSU, NBU staff estimates

Administered Prices, %



Source: SSSU, NBU staff estimates

3.3. THE REAL ECONOMY

In 2017, economic growth is expected to slow to 1.6% triggered by production declines in certain industrial sectors following the suspension of cargo trade across the line of contact in Donetsk and Luhansk oblasts and the seizure of enterprises located in the uncontrolled territories. At a time of growing need for energy imports, the loss of export-oriented production capacities in the non-government controlled area (NGCA) will result in a negative contribution of net exports to the change in GDP.

Economic growth is projected to accelerate to 3.2% in 2018 and 4.0% in 2019. The growth will be primarily driven by the easing of fiscal and monetary policies, which will bolster consumer demand, enhance the economy's investment attractiveness, boost export growth on the back of improved terms of trade, increase crop yields, and help secure alternative raw material supplies after the suspension of cargo trade across the line of contact. At the same time, imports will satisfy a significant part of domestic demand and investment in fixed assets. As a result, the contribution of net exports in the forecast period will be close to zero.

Private consumption will be the main driver of economic growth over the forecast period. The current year will see private consumption grow 4.9%, followed by 3.6% next year, mainly as real wages increase as part of the government's efforts to raise living standards. However, the growth will be restrained by the continued decrease of subsidy rates for utility payments, which will partially offset rising wages and pensions. The gradual pickup in lending underpinned by interest rate cuts in the economy is expected to further bolster private consumption in the medium term.

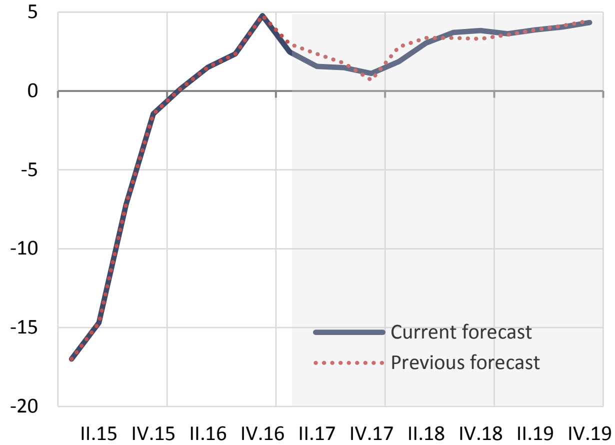
The growth of investment into the economy will slow to 7.4% this year on the back of businesses' higher labor costs and the statistical effect of a high comparison base (after last year's 20.1% increase). As before, the agricultural and mining sectors will see buoyant investment (especially companies that stepped in to take the place of supplies from the NGCA), as will overland transport (in particular railways) and the service sector, which have both shown steady growth of investment in previous periods (particularly health care). The implementation of energy sector projects designed to reduce Ukraine's dependence on imported coal will also boost capital investment. The pace of investment growth (5-7% per annum) is expected to exceed the average economic growth rate over the forecast horizon.

The growth of capital investment will lead to higher investment imports, especially machinery and equipment, which are in demand among farmers. Households are expected to also create additional demand for imported goods as real disposable incomes grow.

Import volume will grow 8% in 2017, driven by the need to replace goods that were previously supplied from the areas now not under government control.

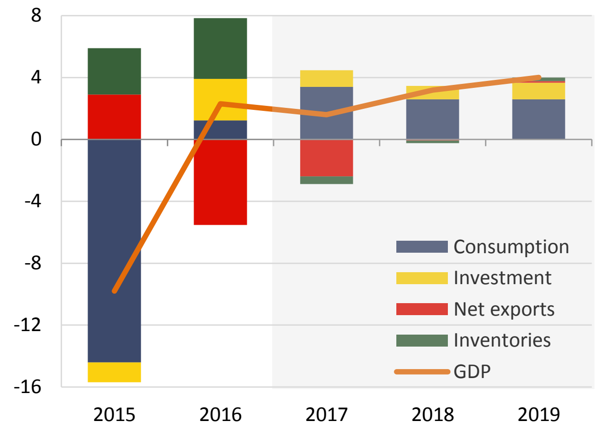
This will mostly affect energy imports, and growth will come from a shift towards external sources of coal supplies and continued economic growth. Gas imports are expected to

Real GDP, % yoy



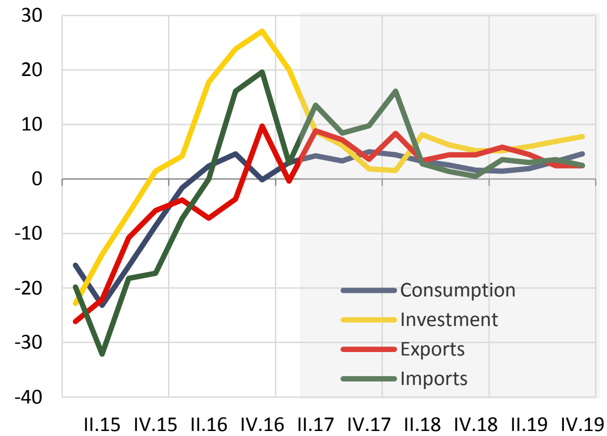
Source: SSSU, NBU staff estimates

Contributions to Real GDP Growth, pp



Source: NBU staff estimates

GDP Growth by Components, % yoy



Source: SSSU, NBU staff estimates

remain close to last year's levels. In the medium term, any decrease in energy imports will be determined both by the implementation of energy-saving initiatives and increases in the domestic extraction of primary energy sources.

In 2017, export volume is expected to grow almost 5%, which would constitute the first year of growth after five straight years of declines. Higher agricultural exports (new markets and more favorable pricing on global commodity markets), particularly grains, oils, meat and dairy products, and sugar will support the growth. Machinery and iron ore exports are also expected to recover, which will mitigate the impact on real exports caused by the metallurgical sector, which has suffered from the trade interruptions.

In 2018, metallurgical producers are expected to return to previous production levels as they tap into alternate sources of raw material supplies after the supply chain interruptions from the NGCA. That will enable Ukrainian metallurgical producers to recover lost output and grow exports. Positive external market conditions and high yields on grains and oilseeds will also contribute to export growth over the forecast horizon (4%-6% per annum).

Evaluating potential GDP and the cyclical position of the Ukrainian economy

In Q2 2017, potential GDP continued to grow in annual terms. The growth rate is projected to accelerate to 3.1% by late 2019. Growth will be propelled by an increase in total output productivity, which is determined by institutional and infrastructural factors. This trend reflects the real convergence of Ukraine's economy with advanced economies as the structural reform agenda rolls on.

However, the suspension of trade ties with the NGCA weighs on potential GDP growth. The loss of enterprises in areas of Donetsk and Luhansk oblasts and the forced shift in production chains to the controlled territory will hold back potential GDP growth in 2017. However, growth will resume in 2018. The economy's low capitalization is another factor dragging down potential GDP growth. Fixed capital formation will be below depreciation over the forecast horizon.

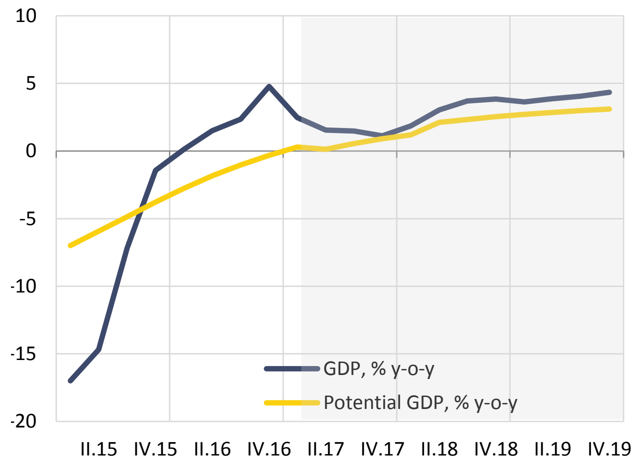
A reduction in the supply of labor amid an unfavorable demographic trend caused by migration processes and other factors is another constraint. At the same time, structural labor market imbalances result in a high natural rate of unemployment.

The output gap was negative in H1 2017. The widening of the gap in Q1 from the previous quarter occurred as the effect from temporary surge of agricultural production in Q4 last year faded and as freight traffic across the line of contact stopped. However, the negative gap is expected to narrow over the forecast horizon and disappear entirely by the end of 2019. The narrowing will be the result of the planned easing of monetary and fiscal policies and the revival of consumer and investment demand.

In 2017, fiscal policy will have an uneven effect on the economy – policy was relatively tight in H1 but will ease in H2. Consequently, this year's structural deficit is projected to be higher than last year.

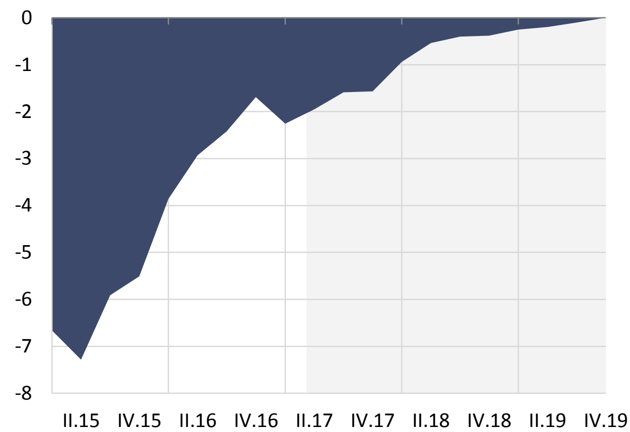
Fiscal stimulus will positively impact aggregate demand this year as private consumption grows (particularly after the

Potential GDP, % yoy



Source: SSSU, NBU staff estimates

GDP Gap, %



Source: NBU staff estimates

minimum wage increases since the start of the year) and average pensions increase as a result of the proposed pension reform. Over the mid-term, any further easing of fiscal policy will be constrained by the need to keep the public sector deficit within the range agreed on with the IMF.

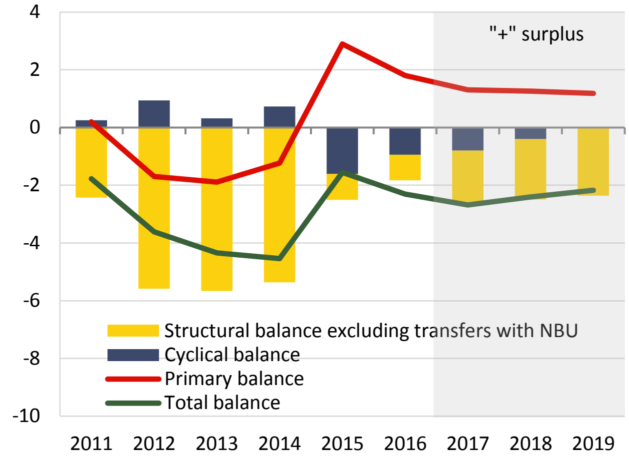
The government's announced pension reform will have the largest impact on private consumption (as incomes rise). Inflationary pressure stemming from the increase in pensions will be insignificant as long as the budget deficit remains unchanged, since the easing of fiscal policy will face constraints due to the need to keep the public-sector deficit within the range agreed on with the IMF. In this situation, higher pension expenditures will be balanced by a reduction of other expenses and higher contributions under the unified social tax (UST). Additionally, changes to the pension system (especially the minimum qualifying period) are expected to help bring Ukraine's labor market out of the shadows.

The pension reform will have a minor effect on the balances of the consolidated budget and the public sector budget. Overall, in 2017-2019 the public sector deficit will be below 3% of GDP, while the primary surplus is expected to exceed 1% of GDP due to a high debt burden.

Consolidated budget revenues this year will grow faster than overall inflation. The NBU expects individual income tax receipts will grow at the highest rate. At the same time, increases in spending on salaries and wages, as well as other social spending (such as utility subsidies for households) will also grow rapidly. Capital expenditures may grow to more than 3% of GDP on the back of the government's pledge to finance the construction of roads.

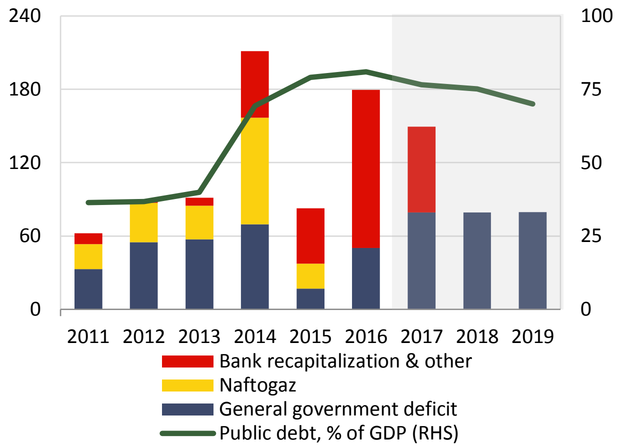
Looking ahead, the quasi-fiscal needs of the banking sector and the Deposit Guarantee Fund (DGF) will be moderate, while Naftogaz of Ukraine NJSC will no longer need budget support after it raised energy rates to cost-recovery levels. Given the implementation of fiscal policy as described above and considering Ukraine's projected borrowing needs (including IMF tranches), public and state-guaranteed debt relative to GDP will decrease to 75% in 2017-2018 and 70% in 2019.

Consolidated Budget, % of GDP



Source: NBU staff estimates

Public Sector Deficit, UAH bn



Source: MFU, SSSU, NBU staff estimates

3.4. BALANCE OF PAYMENTS

The current account deficit is expected to remain close to 4% of GDP in 2017-2018. In 2019, the deficit is expected to decline to 3% of GDP as export competitiveness improves and demand rises on a recovery of domestic demand. Import growth will be driven by the need to boost capital investment and by an improvement in consumer confidence over the medium term. This will be partly offset by an increase in commodity exports and consumer goods as terms of trade improve. External demand is expected to remain favorable over the forecast horizon as growth in Ukraine's major trading partners (MTPs) is projected to accelerate in 2017-2019. The external price environment for Ukrainian exporters will stabilize at current levels and improve slightly in 2018-2019: prices for ferrous metals will remain high and grain prices will recover, which will offset a drop in iron ore prices and a moderate pick-up in oil prices.

The current account deficit will be entirely offset by inflows to the financial account, which will enable a further growth of international reserves. In 2017, a decline in FX cash outside banks will be the main source of capital inflows. In 2018-2019, an improved investment climate will help restart investment and debt capital inflows to the private sector. Moreover, as external capital markets become accessible once again, the government is expected to float sovereign Eurobonds, which would enable it to refinance a portion of public debt, as payments on that debt are scheduled to peak in 2019. This forecast also includes the use of confiscated funds to repay public debt.

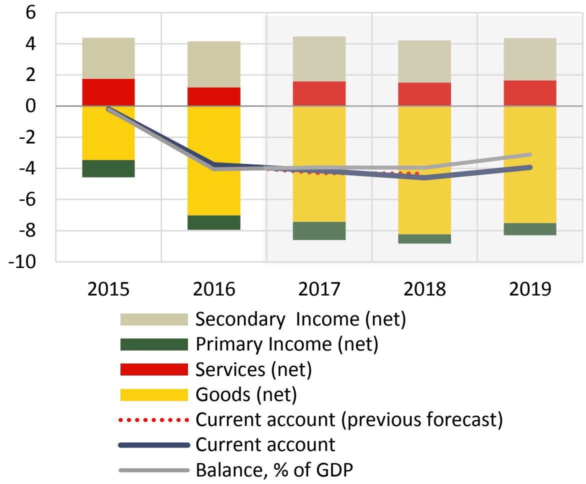
As a result, of the overall balance of payments surplus together with IMF financing, international reserves will grow to USD 27.1 billion, or 5.2 months of future imports as of the end of 2018. By the end of 2019, however, international reserves will decrease to USD 25.7 billion, or 4.8 months of future imports, owing to sizable public debt repayments.

The current account deficit in 2017 will remain at the previous year's level of 3.9% of GDP as exports and imports grow at a similar pace. Record high grain exports in the 2016-2017 marketing year (MY) and improved trade conditions will drive growth in goods exports. At the same time, imports are expected to grow significantly (especially coal) because of price factors and due to the need to increase volumes after the suspension of cargo trade with the uncontrolled territories (UCT). Imports of machinery will remain high, driven by the need to upgrade obsolete fixed assets. The repatriation of dividends is projected to grow after the decision to allow dividends accrued in 2016 to be paid as Ukrainian companies and banks have reported better financials.

For the first time since 2012, goods exports are expected to grow in 2017 (15.1%) across most categories of goods, primarily owing to a rebound in commodity prices and growing supplies, mainly of consumer goods.

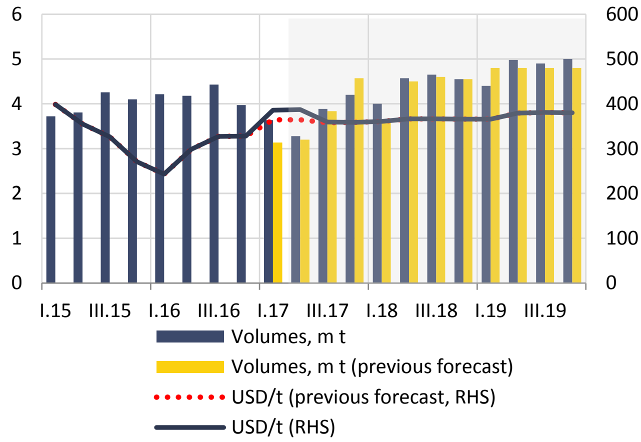
Ore exports will see the highest growth (41.3%) on the back

Current Account, USD bn



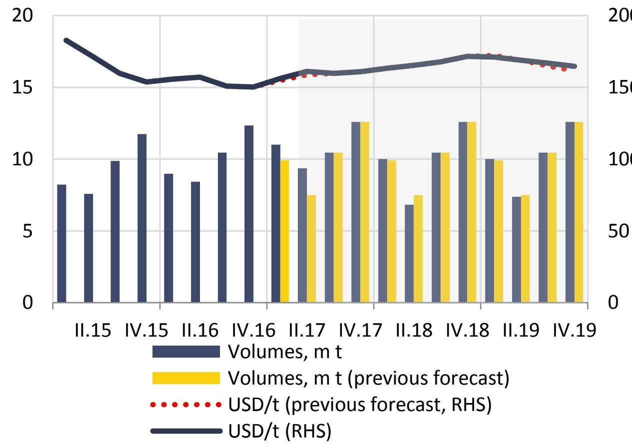
Source: NBU

Ferrous Metals Exports (four main sub-groups)



Source: NBU

Grains Exports



Source: NBU

of rising prices (30.2%) and additional volumes released after shipments to metallurgical producers in the UCT stopped. Shipments of food products are also projected to grow (15.7%), especially sugar, milk, and meat thanks to the opening of new sales markets, primarily in Asia. A record harvest in 2016 and high inventory levels will drive growth in exports of grains and oilseeds. Despite a decline of metallurgical export volumes, the value of exports will grow 10.9% thanks to a favorable pricing environment. Machinery exports are also forecast to grow, primarily on the expansion of a line of shipments of car parts to EU countries due to lower production costs in Ukraine.

In 2017, the growth of goods imports is projected to accelerate (to 13.5%), mainly due to energy imports. The increase in energy imports by 37.8% will be driven by higher imports of coal and coke to replace supplies from Donetsk and Luhansk oblasts, as well as by increased prices for oil products and gas. Non-energy imports will continue to rise rapidly, driven mostly by machinery imports resulting from high demand from agricultural enterprises and the improvement in consumer sentiment. Declining supplies of domestically produced fertilizers will prompt growth in imports. Growth in most non-energy imports will be partially offset by a decline in unofficial imports on a revision of the methodology used.

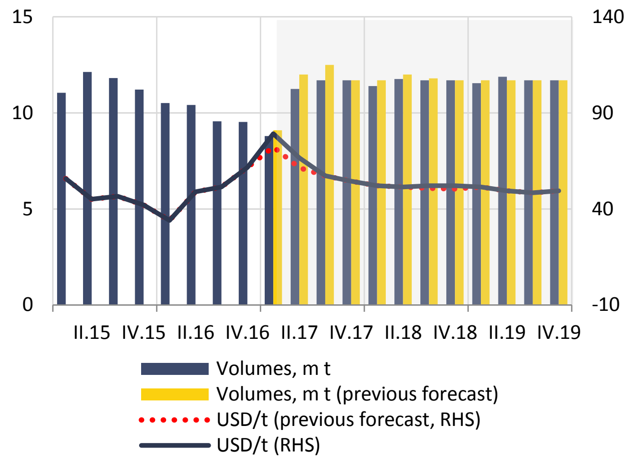
Compared to the previous forecast, growth of goods exports has been upgraded by 3.9 pp as a result of larger grains exports as of the end of the 2016/2017 MY, growth in supplies of other food products, and higher-than-expected commodities prices in H1. The growth rate of goods imports was also revised upwards by 2.5 pp, primarily due to rising coal prices, greater demand for machinery, and higher imports of fertilizers.

An increase in the services trade surplus will be driven by growing exports of services (7.6%) primarily as revenues from gas transportation and other transport services grow, and IT services volumes increase. Imports of services will grow 5.2% on the back of growing travel expenses and higher imports of transportation services amid an increase in the turnover of goods.

Remittances are expected to grow modestly (1.9%) in 2017 as the number of migrant workers increases, primarily in the EU and the US. Russia's ban on money transfers to Ukraine via international payment systems will push a shift towards banks and unofficial channels. The forecast also incorporates the projected growth of dividend repatriation (by USD 0.7 billion) after the government allowed payments of dividends accrued in 2014-2016 to foreign investors. At the same time, interest payments will fall slightly as the share of private sector external debt decreases. Private sector borrowings are more expensive than public sector debt.

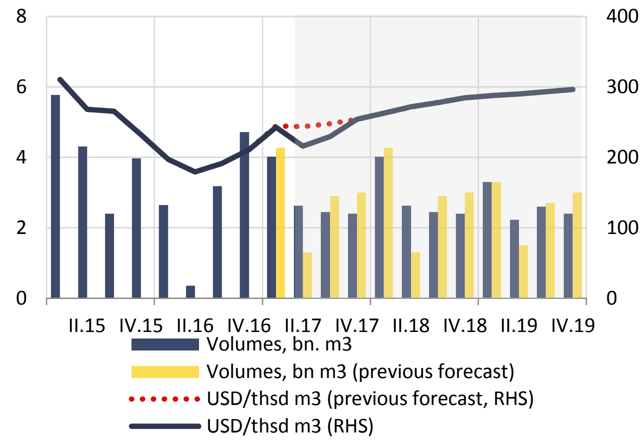
In 2018, the current account deficit is expected to remain close to the levels of previous years as an increase in investment and consumer imports will offset the recovery in exports. However, starting from 2019 the deficit is projected to narrow gradually as export growth accelerates,

Iron Ore Exports



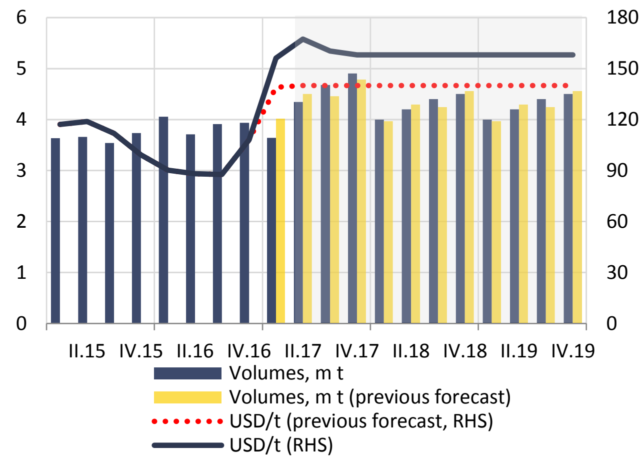
Source: NBU

Gas Imports



Source: NBU

Coal imports



Source: NBU

underpinned by large capital investment from previous periods.

In 2018, the growth in goods exports will be driven primarily by metallurgical products as contracts get executed that had been in previous years fulfilled by production facilities located in the UCT. In addition, in 2018-2019 an acceleration of economic growth rates in Ukraine's major trading partners will enable a gradual increase of most of Ukraine's commodity exports.

An increase in goods imports in 2018 will come in both energy and non-energy imports, while in 2019, only non-energy imports will drive growth. Gradual price growth will drive energy imports in 2018, whereas in 2019 energy imports will fall as demand for imported gas weakens as energy-saving initiatives get implemented and domestic gas production rises. Further ixed asset upgrades amid stronger business expectations and the improved cost-effectiveness of export-oriented industries will drive the growth of non-energy imports in 2018-2019. Consumer demand will also increase gradually as households' real incomes grow.

Services exports and imports will continue to grow in 2018-2019 driven by the recovery of business activity resulting in a higher volume of transportation services. Private remittances are also expected to boost revenues.

In 2017, net financial account inflows are projected to grow slightly to USD 5.9 billion. The capital inflows will come largely from a reduction of FX cash outside banks (USD 3.2 billion) on the back of persistently low real household incomes, a stable FX market, andhigh interest rates on hryvnia-denominated deposits.

FDI is expected to remain at the previous year's level (USD 1 billion) in 2017, net of debt-to-equity operations of the banking sector.

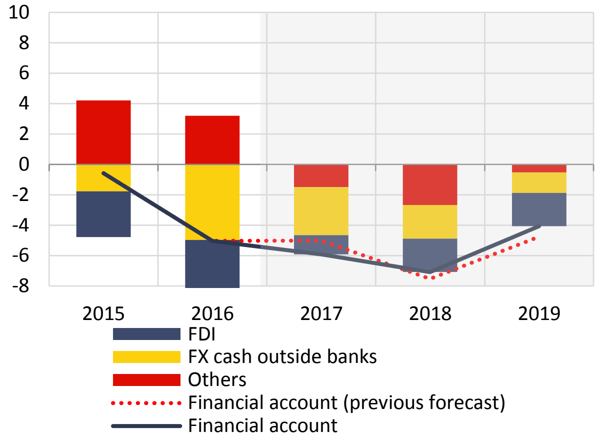
With the private sector gradually regaining access to foreign capital markets in 2017, the need to service and repay debt will remain high. The private sector will have a higher long-term external debt rollover rate of around 78% and net debt outflows of an estimated USD 1 billion.

In 2017, the EU is expected to disburse two loans for a total USD 1.3 billion in addition to USD 0.3 billion pledged by other donors. In addition, public sector repayments of foreign currency debt by means of confiscated funds will help boost further international reserves in 2017 and 2018.

Accordingly, in 2017, the surplus of the overall balance of payments (USD 1.8 billion) combined with net inflows from the IMF under the EFF program (USD 2.1 billion) will increase international reserves to USD 20 billion, or 4.0 months of future imports.

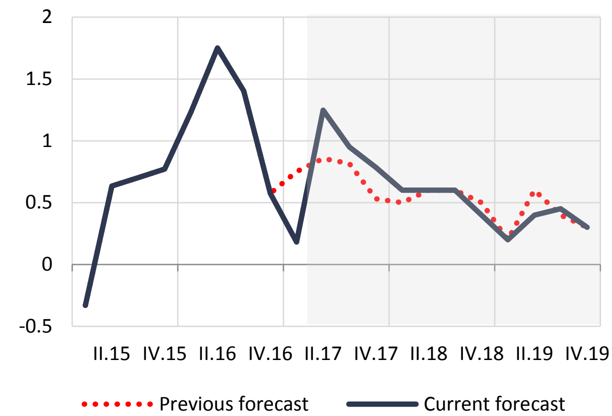
An improvement of the investment climate will help investment and debt capital inflows resume in 2018-2019. As a result, the rollover rate of long-term private debt will rise to 100% in 2018 and 105% in 2019, and FDI is expected to grow to USD 2.2 billion in both years, with the real sector being a major recipient of FDI. In 2018, the rate of decline

Financial Account, USD bn



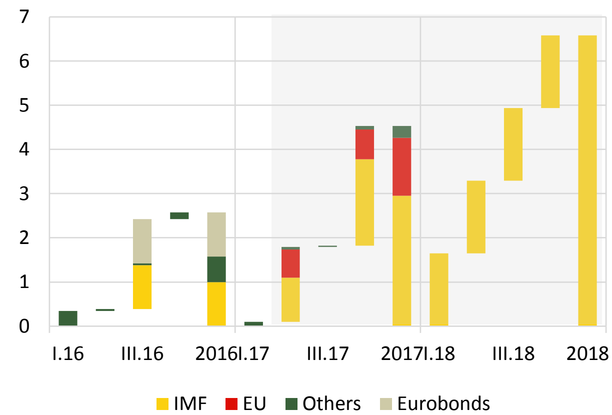
Source: NBU

FX Cash Outside Banks, USD bn



Source: NBU

Official Financing in 2016-2018, USD bn

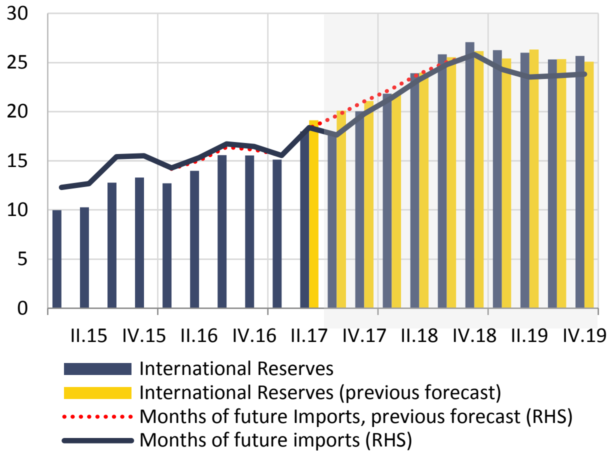


Source: NBU

of FX cash outside banks will slow (to USD 2.2 billion) as rising real household incomes decrease the need to convert currency savings. The decline of FX cash outside banks will remain comparable to investment capital inflows. Financial account inflows in 2018 will reach USD 7.1 billion, including the expected placement of USD 2 billion in government Eurobonds. However, financial account inflows are forecasted to drop to USD 4.1 billion in 2019 as government debt repayments peak.

In 2018, a USD 2.5 billion surplus on the overall balance of payments and the IMF tranche of USD 4.5 billion under the EFF will increase international reserves to USD 27.1 billion, or 5.2 months of future imports. This figure will be close to 100% of the IMF's composite measure for reserve adequacy. In 2019, however, international reserves will decrease to USD 25.7 billion, or 4.8 months of future imports, owing to sizable repayments under IMF loans of USD 1.6 billion.

International Reserves, USD bn



Source: NBU

3.5. THE MONETARY SECTOR AND FINANCIAL MARKETS

In H2 2017, an assessment of the medium-term risks related to the inflation targets will define any further easing of monetary policy and the liberalization of the FX market. The banking system will continue to enjoy surplus liquidity this year, with the interest rate paid on certificates of deposit remaining a major monetary policy instrument. The dollarization of the economy is expected to decrease as demand for the hryvnia grows.

The growth of monetary aggregates in Q2 2017 was lower than forecasted against the background of a slower recovery of demand for both cash and FX deposits. Demand for hryvnia cash is expected to grow gradually in H2 as economic activity grows and seasonal factors play a role. The monetary base is expected to grow approximately 6% this year, driven by an increase in both cash outside banks and money held in correspondent bank accounts.

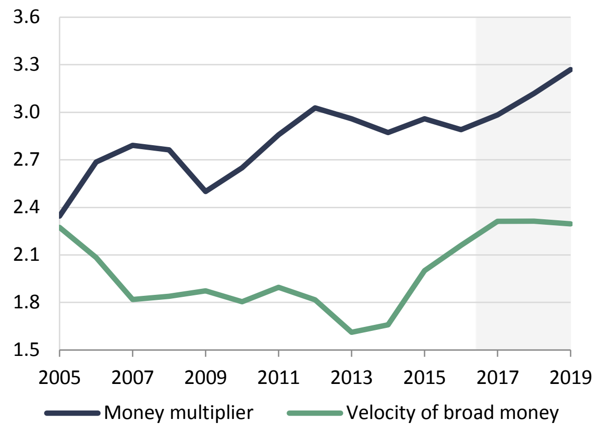
The public's growing confidence in the banking system, an increase business activity, and higher real household incomes will support the ongoing inflow of deposits to banks. Deposits will increase at a faster pace (11%) than cash outside banks (5%) this year. A larger share of cashless payments and a gradual recovery in lending will boost the money multiplier. The money supply is expected to grow 9% yoy this year.

Given favorable conditions, the NBU will continue easing monetary policy, which will gradually decrease bank interest rates. With surplus liquidity in the banking sector, the NBU's issuance of certificates of deposit will remain the main instrument for regulating interbank interest rates. The main source of the banking system's liquidity will be the NBU's profit transfers to the budget and FX purchases to replenish international reserves. The government's repayments of securities held in the NBU portfolio as they mature are the most significant drain on liquidity.

Monetary policy in 2018-2019 will aim to maintain the disinflation trend while keeping inflation within its target range and bringing down lending costs. The implementation of that monetary policy approach will depend on the assessment of risks pertaining to price stability and inflation expectations. Monetary conditions will also depend on a prudent fiscal policy in the coming years.

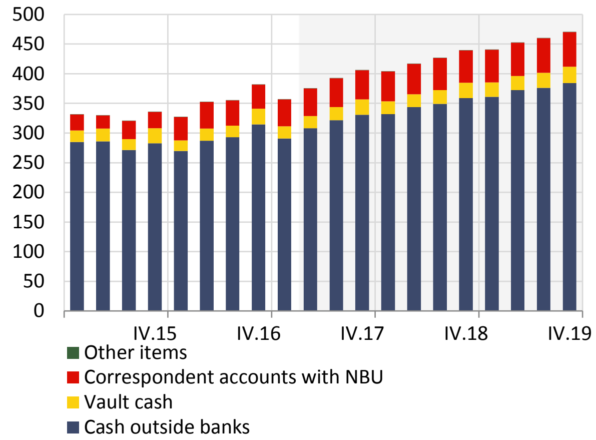
The money supply is expected to increase in 2018-2019 (14% and 13%, respectively) owing to both the deposit and cash components, as well as further growth in the money multiplier. Under these conditions, the growth rate of the monetary base during this period (8% in 2018 and 6% in 2019) will be below the rate of growth of the money supply.

Money Multiplier and Money Velocity



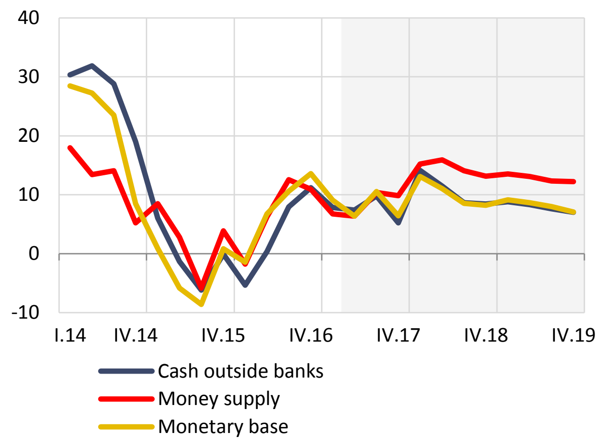
Source: NBU

Monetary Base (Components), UAH bn



Source: NBU

Monetary Indicators, % y-o-y



Source: NBU

3.6. RISKS TO THE FORECAST

The risks to inflation and economic growth projections are balanced over the mid-term.

The situation in Eastern Ukraine will remain the main source of uncertainty. Any favorable developments in Ukraine would serve to decrease risk premiums, which would improve investment attractiveness, boost capital inflows, accelerate economic growth, and drive an appreciation of the hryvnia. However, any escalation of hostilities would damage expectations and bring negative social and economic consequences.

In addition, the efficacy of measures by the private sector and the government to minimize losses from the suspension of trade with the uncontrolled territories (UCT) will remain a major domestic risk.

Furthermore, the inflation trend this year and next may be affected by food product supply-side shocks.

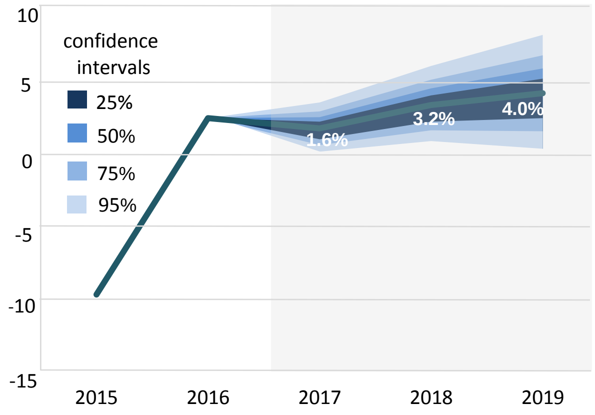
Another source of uncertainty for inflation is related to an increase in administered tariffs, which could lead to deviations of inflation from the projected trajectory in both directions. Growth in natural gas rates by the end of this year will introduce additional inflationary pressure, but this will fade in 2018. In addition, there remains a measure of uncertainty in the economy related to the implementation of a prudent macroeconomic policy and the structural reforms required to maintain macrofinancial stability, boost economic potential, and continue working with the IMF. Ineffective reforms could push risk premiums up, which would impact inflation and exchange rate expectations and strengthen inflationary pressure.

In the fiscal sector, the biggest risk for prices stems from the possibility for increased government spending on social initiatives that are inconsistent with the inflation targets. Additionally, the reform of the pension system and the potential for a dramatic increase in pension payments also carry some risk for inflation over the medium term. Another risk is related to changes in the government's policy on household subsidies, which will impact households' real incomes and, respectively, aggregate demand in the economy. The greater emphasis placed by the government on financing current social expenditures can not only accelerate inflation, but also curb government investment and raise debt levels, which will impact economic growth prospects over the medium term.

Global commodity prices will be a major external risk for the economy. In an optimistic scenario, global prices would rise rapidly, as would demand for Ukrainian products. Under this scenario, growing economic activity will be accompanied by a strengthening of the hryvnia thanks to higher export proceeds and capital inflows to the financial account. In that case, the impact on the inflation trend would be bi-directional: higher rates of economic growth would stimulate inflation, while a strengthening of the hryvnia would curtail price growth. The balance of their influence would define the monetary policy response.

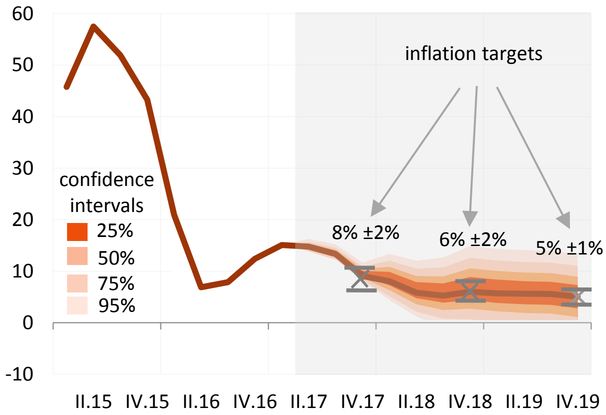
For Ukraine, the upside would be in a scenario where energy prices (oil, gas, and coal) decrease versus the NBU's baseline scenario. This would boost Ukraine's economic growth with

Real GDP Growth, % yoy



Source: NBU

CPI Growth Forecast and Targets, % yoy



Source: NBU

The forecast is given in a fan chart. This chart type is used to illustrate uncertainty with regard to predicted future values. For instance, the probability that the inflation rate will be in the range of the darkest shaded area in the chart (around the central line) is 25%. The same applies to other chart areas, implying the 95% probability that the inflation rate will be in the range of the lightest shaded area.

a direct effect on domestic consumer prices and an indirect impact through a lower cost of imports and a correspondent adjustment of the exchange rate.

If commodity prices fall, Ukraine’s export revenues would decrease, which, in turn, will put pressure on the current account and the hryvnia exchange rate. At the same time, the weaker competitiveness of domestic export-oriented enterprises and their diminishing effective demand would restrain economic activity. The major factor capable of mitigating that risk to price stability and economic growth is largely beyond the reach of the National Bank of Ukraine. The most apt response would be the implementation of structural reforms that would transform the commodity-based nature of Ukraine’s economy. However, through the use of monetary policy instruments, the NBU can mitigate the impact of shocks and help the economy return to equilibrium.

If these and other risks materialize over the forecast period, inflation may deviate from its projected path, which would then prompt a monetary policy response.

Macroeconomic forecast (July 2017)

Indicators	2013	2014	2015	2016	2017						2018						2019					
					I	II	III	IV	current forecast	forecast 04.2017	I	II	III	IV	current forecast	forecast 04.2017	I	II	III	IV	current forecast	forecast 04.2017
REAL ECONOMY, % yoy, unless otherwise stated																						
Nominal GDP (SNA'2008), UAH bn	**1465**	**1587**	**1989**	**2383**	584	639	799	828	**2850**	2755	655	724	905	937	**3220**	3106	727	804	1007	1046	**3585**	3460
Real GDP	**0.0**	**-6.6**	**-9.8**	**2.3**	2.5	1.5	1.5	1.1	**1.6**	1.9	1.9	3.0	3.7	3.8	**3.2**	3.2	3.6	3.9	4.1	4.3	**4.0**	4.0
GDP Deflator	**4.3**	**15.9**	**38.9**	**17.1**	25.1	17.5	15.0	13.3	**17.7**	13.5	10.0	10.0	9.0	9.0	**9.5**	9.2	7.2	7.0	7.0	7.0	**7.1**	7.1
Consumer prices (period average)	-0.3	12.1	48.7	13.9	-	-	-	-	12.7	12.4	-	-	-	-	8.2	7.4	-	-	-	-	6.0	5.5
Producer prices (period average)	-0.1	17.1	36.0	20.5	-	-	-	-	25.6	25.1	-	-	-	-	10.9	9.6	-	-	-	-	8.8	8.0
Consumer prices	**0.5**	**24.9**	**43.3**	**12.4**	15.1	14.8	13.3	9.1	**9.1**	9.1	8.1	5.8	5.3	6.0	**6.0**	6.0	5.7	5.6	5.6	5.0	**5.0**	5.0
Core inflation	0.1	22.8	34.7	5.8	6.3	6.5	6.3	6.1	6.1	6.5	5.5	5.5	4.5	3.9	3.9	4.3	3.7	3.4	3.2	2.8	2.8	3.7
Non-core inflation	0.9	26.8	50.9	18.3	26.8	25.8	22.7	13.0	13.0	12.5	11.5	6.2	6.3	8.8	8.8	8.4	8.3	8.5	8.8	8.0	8.0	6.8
raw foods	-2.3	23.2	40.7	1.2	7.5	19.8	16.6	11.8	11.8	7.8	10.4	0.2	1.3	3.6	3.6	3.8	2.8	3.4	4.3	2.5	2.5	3.3
administrative prices	3.5	29.0	64.4	34.6	39.5	28.3	24.3	13.8	13.8	16.0	12.0	10.0	9.0	12.3	12.3	11.6	12.1	11.8	11.5	11.5	11.5	9.7
Producer prices	**1.7**	**31.8**	**25.4**	**35.7**	38.3	27.5	22.3	12.7	**12.7**	12.2	9.2	12.0	10.5	9.8	**9.8**	9.7	9.0	8.4	8.4	8.2	**8.2**	7.9
FISCAL SECTOR																						
Consolidated budget balance, UAH bn	**-63.6**	**-72.0**	**-30.9**	**-54.8**	-	-	-	-	**-76.4**	-76.8	-	-	-	-	**-77.4**	-72.6	-	-	-	-	**-77.8**	-72.4
% of GDP	-4.3	-4.5	-1.6	-2.3	-	-	-	-	-2.7	-2.8	-	-	-	-	-2.4	-2.3	-	-	-	-	-2.2	-2.1
Public sector fiscal balance (IMF methodology), UAH bn	**-57.5**	**-70.3**	**-17.0**	**-50.3**	-	-	-	-	**-79.4**	-79.3	-	-	-	-	**-79.2**	-74.8	-	-	-	-	**-79.5**	-77.8
% of GDP	-3.9	-4.4	-0.9	-2.1	-	-	-	-	-2.8	-2.9	-	-	-	-	-2.5	-2.4	-	-	-	-	-2.2	-2.2
General government and Naftogaz financing, UAH bn	-85.0	-157.6	-37.5	-50.3	-	-	-	-	-79.4	-79.3	-	-	-	-	-79.2	-74.8	-	-	-	-	-79.5	-77.8
General government and Naftogaz financing, % of GDP	-5.8	-9.9	-1.9	-2.1	-	-	-	-	-2.8	-2.9	-	-	-	-	-2.5	-2.4	-	-	-	-	-2.2	-2.2
BALANCE OF PAYMENTS (NBU methodology)																						
Current account balance, USD bn	-16.5	-4.6	-0.2	-3.8	-0.8	-0.6	-1.7	-1.0	-4.1	-4.3	-1.7	-0.2	-1.6	-1.1	-4.6	-4.3	-1.4	-0.1	-1.7	-0.8	-3.9	-4.3
Financial account, USD bn	-18.6	9.1	-0.6	-5.0	-0.2	-2.0	-1.7	-2.0	-5.9	-5.0	-2.3	-1.1	-2.4	-1.2	-7.1	-7.5	-1.1	-0.3	-1.5	-1.1	-4.1	-4.8
BOP overall balance, USD bn	**2.0**	**-13.3**	**0.8**	**1.3**	-0.6	1.4	-0.1	1.0	**1.8**	0.7	0.6	0.9	0.8	0.1	**2.5**	3.2	-0.3	0.2	-0.1	0.3	**0.1**	0.5
Gross international reserves, USD bn	**20.4**	**7.5**	**13.3**	**15.5**	15.1	18.0	17.6	20.0	**20.0**	21.1	21.8	23.9	25.8	27.1	**27.1**	26.2	26.3	26.0	25.3	25.7	**25.7**	25.1
Months of future imports	**3.5**	**1.8**	**3.1**	**3.2**	3.1	3.7	3.5	4.0	**4.0**	4.2	4.3	4.7	5.0	5.2	**5.2**	5.1	4.9	4.7	4.7	4.8	**4.8**	4.7
Export of goods, % yoy	-8.3	-14.5	-29.9	-5.2	36.8	10.9	11.4	6.4	15.1	11.2	-6.1	5.4	9.1	7.4	4.0	6.5	5.8	5.3	5.3	6.1	5.6	5.0
Import of goods, % yoy	-5.8	-29.0	-32.6	4.4	21.6	22.5	9.2	4.8	13.5	11.0	3.8	2.3	7.6	6.3	5.1	5.7	2.6	2.9	5.5	1.8	3.2	3.0
MONETARY ACCOUNTS (Cumulative since the beginning of the year)																						
Monetary base, %	**20.3**	**8.5**	**0.8**	**13.6**	-6.5	0.0	2.9	6.4	**6.4**	6.3	-0.6	2.0	4.4	7.8	**7.8**	7.8	-0.4	1.7	3.6	6.0	**6.0**	6.5
Broad money, %	**17.6**	**5.3**	**3.9**	**10.9**	-2.5	0.2	5.3	9.0	**9.0**	10.7	2.8	5.3	9.6	13.5	**13.5**	12.8	2.5	5.1	8.9	12.6	**12.6**	12.0
Velocity of broad money (end of year)	**1.61**	**1.66**	**2.0**	**2.2**	-	-	-	-	**2.4**	2.3	-	-	-	-	**2.4**	2.3	-	-	-	-	**2.3**	2.2