

Gates of the unknown open wide

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Calendar of Events

Three weeks have passed since the name of the sixth president of Ukraine was confirmed. But neither key appointments nor the first steps of the new administration have been announced. President-elect Volodymyr Zelenskiy's advisors are busily making comments, but none of these speakers have official appointments -- so such statements are, at this stage, little more than personal views. This state of affairs has generated a broad space for conspiracy theories to flourish. Over the last few weeks, it's been possible to read a wide spectrum of potential scenarios, based mainly on the imaginations of the authors. Meanwhile, Zelenskiy seems in no hurry to dot the i's and cross the t's.

The main debate is over the date of Zelenskiy's inauguration. If it takes place before May 27th, the president-elect will be in a position to call a snap Verkhovna Rada election. It's not clear what he might gain from such a move, given that regular elections are already set for the end of October. But pundits claim that Zelenskiy should be willing to do this, postulating that if elections take place a months earlier, the president will win a larger faction in the legislature (although he currently has no real party anyway). Zelenskiy himself has said nothing about his intentions, although he has been understandably vociferous about the foot-dragging over setting his inauguration date.

Though uncertainty continues to dominate, good macroeconomic fundamentals are keeping economic players relatively calm. Ukraine's economy is growing, the hryvnia is strengthening and the IMF has been sending positive signals >>>

Everything is uncertain

We would be very disingenuous with our readers if we claimed to know in which direction Ukraine was headed. The results of the presidential race have completely broken and disoriented the country's establishment. What we know for sure is that a window of opportunity has opened. But we have no idea what might fly in, or out.

Economic fundamentals are good. GDP is growing, and gross reserves are sufficient to service debt liabilities for the very near future. External accounts have improved, and the hryvnia is stronger. Even the most troublesome issue of gas rates has been resolved: as of May 1st, household gas rates were at market level -- even higher than the IMF required. Against this backdrop, at least one more IMF wire looks secure.

Outgoing President Petro Poroshenko leaves a good inheritance to his successor, and it's a point of confidence that nothing dramatic is likely to happen to the economy, at least over the next half year.

Beyond the knowledge about good macroeconomic fundamentals, though, prospects are obscure.

Various people are circulating around President-elect Volodymyr Zelenskiy, but from what can be seen, none has any official mandate to represent the country's next leader. Zelenskiy refers to all of them as "advisors." And so, anything stated by these individuals needs to be treated as nothing more than their personal views. There's no indication of who will lead the presidential administration -- let alone occupy the other key top-level positions.

What might be treated as Zelenskiy's more or less official position sounds like "Zelenskiy's team is authorized to claim." Zelenskiy himself is not talking much. He shows up in public via short video messages. Ukrainians have even started joking that they have no president, but a "president control center" that should be listened to.

Meanwhile, observers and journalists have decided that Zelenskiy probably wants early Rada elections. Zelenskiy himself has never confirmed this. But observers think he might consider dismissing the legislature, in order to win himself a few months. Old MPs will have less room for maneuver while the new president builds on his success in the presidential race and possibly gains a larger faction in the Verkhovna Rada. Still, the Rada can be dismissed only if Zelenskiy is inaugurated before May 27th. That is likely why we are seeing various board moves around the inauguration date. Zelenskiy has already demanded that MPs set his inauguration for May 19th. Ironically, the old legislature is in charge of choosing the inauguration date.

There is great concern building about the potential fate of Privatbank. Local courts keep delivering decisions that the Privatbank nationalization was illegal. The full text of the decisions has not been made available to the public, but this has not stopped extensive speculation. Some see it as an attempt by judges to give a nod towards former owner Ihor Kolomoyskiy. Others point out that the first Privatbank rulings came before the second round of the presidential election, and have been actively used to raise fears among voters. This means that it cannot be entirely ruled out that the Poroshenko campaign staff itself orchestrated the hubbub around Privatbank. Zelenskiy has kept silent on this issue, which only spurs the imaginations of journalists and various pundits: plenty of theories and scenarios are circulating.

TABLE 1
Summary Table, 2016–2019

	Unit	2017	2018	Feb 2019	Mar 2019	Apr 2019
Output and Expenditures:						
GDP	% y/y	2.5	3.3	-	-	-
Industrial Output Growth	% y/y	0.4	1.6	-2.5	2.1	-
Agricultural Output Growth	% y/y	-2.2	7.8	3.6	3.5	-

	Unit	2017	2018	Feb 2019	Mar 2019	Apr 2019
Organized Retail Trade	% y/y	6.0	5.6	7.9	9.5	-
Monetary and Financial Indicators:						
Money Supply (M3)	% ytd	9.6	5.7	-1.7	-1.9	-
Monetary Base	% ytd	4.6	9.2	-2.9	-2.8	-
Refinancing	mln UAH	41258.9	181172.8	8470.5	2751.3	1448.2
Domestic Credit to Non-Financial Corporations	bln UAH, stock, eop	829.9	859.7	822.9	836.0	-
	%y/y (eop)	1.0	3.6	-2.5	-0.4	-
Domestic Credit to Households	bln UAH, stock, eop	174.2	201.1	202.5	206.6	-
	%y/y (eop)	6.6	15.5	14.2	15.3	-
Prices:						
CPI	% m/m	-	-	0.5	0.9	1.0
	% y/y	14.4	10.9	8.8	8.6	8.8
Core Inflation	% m/m	-	-	0.2	1.2	0.4
	% y/y	7.3	9.1	7.8	7.6	7.4
PPI	% m/m	-	-	1.0	-1.0	-1.5
	% y/y	26.4	17.4	10.2	8.9	7.3
Interest and Exchange rate:						
Prime Rate	%, eop	14.5	18.0	18.0	18.0	17.5
T-bills Yield, in hryvnia, (weighted average)	%	15.0	17.79	19.2	18.8	18.6
Deposit Rate (average)	%	8.3	10.9	12.0	12.1	-
Lending Rate (average)	%	14.6	17.2	16.7	17.2	-
Nominal Exchange Rate	100 USD/UAH	2659.66	2720.05	2716.07	2686.35	2681.15
Real Effective Exchange Rate	2008=100, eop	87.7	99.2	101.97	103.30	
External Accounts:						
Current Account	mln USD	-2442	-4510	-299	-650	-
Trade Balance	mln USD	-8644	-11204	-1 040	-805	-
Foreign Direct Investment	mln USD	2593	2360	-367	-263	-
Reserves	bln USD, eop	18.8	20.8	20.2	20.6	20.5
	months of imports	3.6	3.5	3.4	3.4	3.4
Gross External Debt	eop, bln USD	115.5	114.7	-	-	-
	%, to GDP	102.9	87.9	-	-	-
Fiscal Accounts:						
Consolidated Deficit, (net of loans), cumulative	cumulative bln UAH	40.0	65.9	-4.7	9.5	-
	% of GDP	1.3	1.9	-0.1	0.3	-

	Unit	2017	2018	Feb 2019	Mar 2019	Apr 2019
T-bills in Circulation, cumulative	bln UAH. eop	750.3	756.1	740.7	757.9	768.4
Public Debt	bln UAH. eop	2141.7	2168.6	2111.99	2146.64	-
	% GDP	71.8	61.4	57.7	58.7	-

Source: Derzhkomstat, the state statistics agency, National Bank of Ukraine, Ministry of Finance.

Hryvnia strengthens, but the outlook is bearish

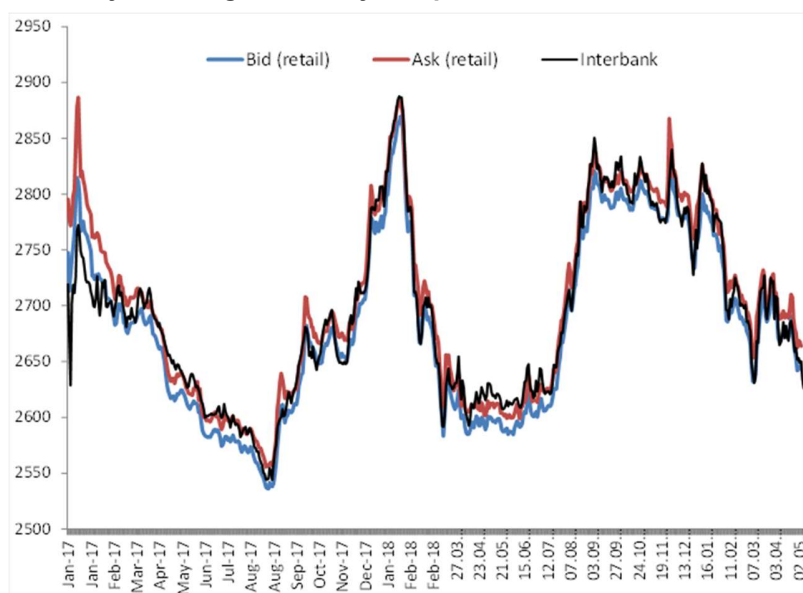
The hryvnia keeps strengthening. In April, the currency gained 2.6%, reaching UAH 26.52 to the dollar by the end of the month. Since the start of the year, the hryvnia has appreciated 4.9%. At the time of this publication, it was UAH 26.38.

Non-resident purchases of Ukrainian government bonds and improving external accounts are the main factors driving the steady appreciation of the hryvnia. Non-residents have already invested \$1.1 billion—\$0.6 billion in April alone—in local state bonds, which is providing substantial support for the hryvnia exchange rate. Although the trend is positive, we expect foreigners to withdraw the funds in H2 2019.

Improvements in the external account also look unsustainable, since to large extent they are driven by a slump in petrol imports.

Against this backdrop, we remain bearish on the hryvnia, and expect the national currency to lose 2.5% y/y over 2019, sliding to \$27.9 on average.

GRAPH 1
Currency Exchange Rate, Hryvnia per \$100



Source: National Bank of Ukraine

Industry recovers by 2.1% in March after slide

After three months of steady decline, industrial output suddenly perked up by 2.1% y/y in March. Recovery took place mainly on the back of stronger metals, up +8.9% y/y, and food processing, up

+7.3% y/y. Chemicals, up +5.2% y/y, and mining, up +1.8% y/y, also contributed to growth but marginally. Utilities plunged 8.1% y/y as warmer weather stabilized. Machinery also dropped, by -1.5% y/y, in the face of weak demand.

Despite a strong March performance, industry remains in the red, with a 0.9% y/y decline for the first three months of 2019. The result is substantially below our initial expectations of 2.4% y/y growth for 2019. However, with concerns over global economic growth eased on the recent release of data from the United States and European Union, we see a good chance for Ukraine's exporting industries to pick up pace by yearend.

GRAPH 2

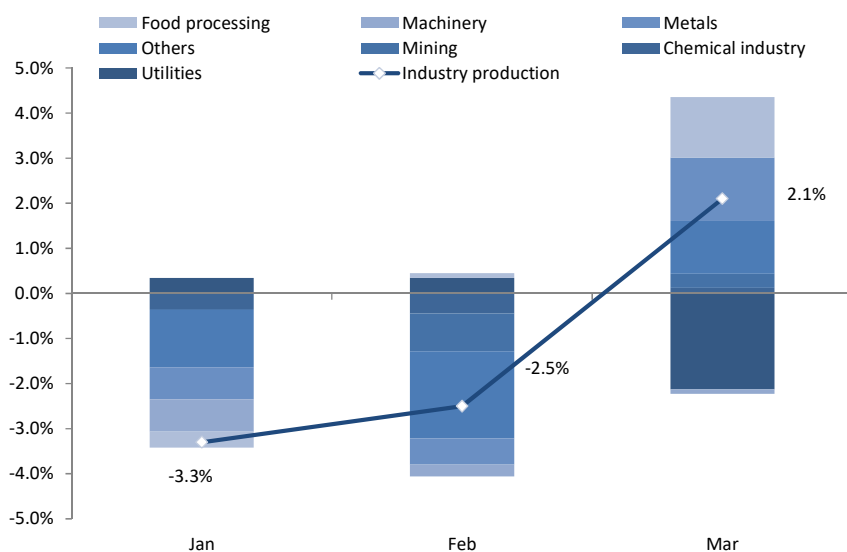
Industrial Performance, %, y/y



Source: Derzhkomstat, the state statistics agency

GRAPH 3

Key Contributors to Industry Growth, %, y/y



Source: Derzhkomstat, the state statistics agency, own estimates

Retail trade rises 9.5% y/y in March

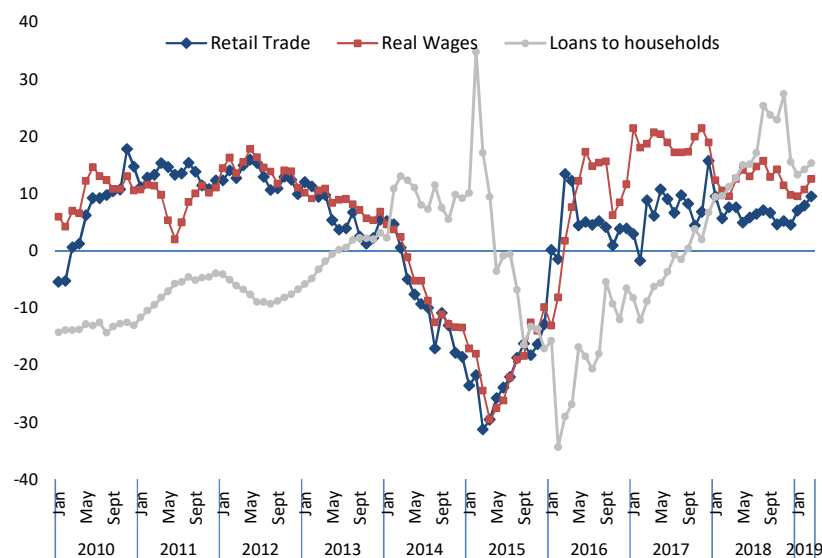
The consumer mood remains strong. Soaring retail trade confirms the resilience of this trend. In March, licensed retail trade sped up to +9.5% y/y from 7.9% y/y in February. For March, retail trade rose by 8.2% y/y.

Remittances from abroad, double-digit growth in real wages, +12.5% y/y for March, and a revival of consumer lending, up +15.3% y/y in March, are feeding active consumption.

We maintain our forecast for private consumption at 5.1% y/y for 2019.

GRAPH 4

Licensed Retail Trade Turnover and Real Wages (% change, y/y)



Source: Derzhkomstat, the state statistics agency

Consumer inflation resumes as food prices climb unexpectedly high

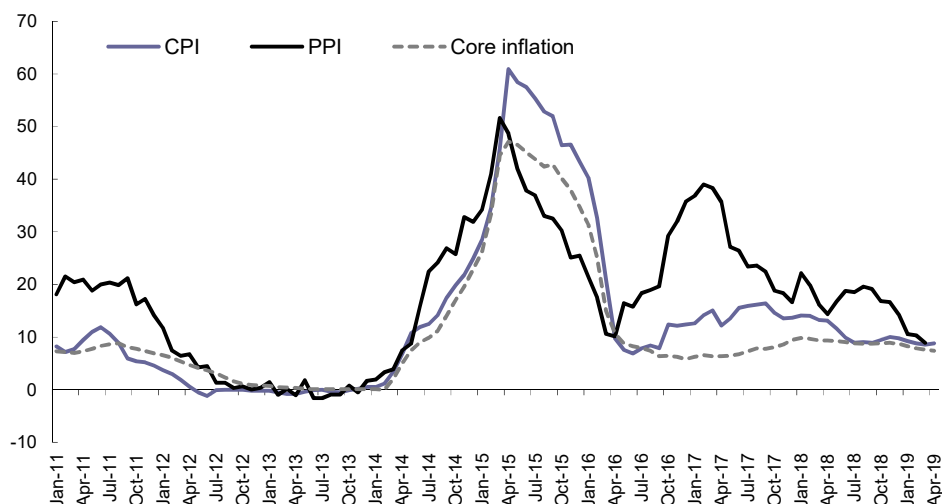
In April, CPI sped up to 1% m/m or +8.8% y/y, compared to +0.9% m/m or +8.6% y/y in March. Still, inflation remains lower than a year ago: by April 2018, consumer inflation was +3.4% ytd down from 4.4% ytd for 4m 2018.

Food inflation, up +1.4% y/y in April, was the main source of CPI growth through the month. Food prices contributed more than half, 0.64 ppt, to CPI growth.

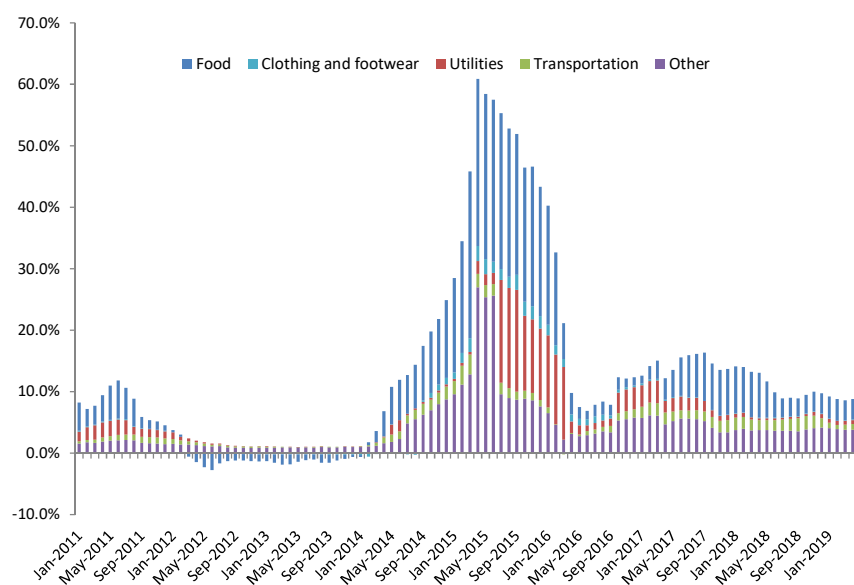
Transportation prices inched up +1.0% m/m, prices for clothing and footwear rose +1.9% y/y, and prices for alcohol and tobacco also inched up +1.2% m/m, also contributing to inflation's upward trend. Transportation prices added 0.11 ppt to the CPI increase, alcohol & tobacco and clothing & footwear added only 0.10 ppt each.

The easing of inflation at the start of the year has already been fully offset by stronger food prices in April and March. After February data was released, we thought CPI might slow faster than we initially projected. However, recent trends have returned it to the trajectory we initially outlined. We are maintaining our initial consumer inflation forecast unchanged, at +6.3% ytd, or +8.4% y/y for 2019.

GRAPH 5

Inflation, 2011-2019 (% change, y/y)


Source: Derzhkomstat, the state statistics agency

GRAPH 6
Inflation breakdown, %, 2011-2019


Source: Derzhkomstat, the state statistics agency

NBU cuts prime rate; demand for bonds keeps rates high

On April 25th, the NBU Board cut the prime rate by 0.5 ppt, to 17.5%. Peaceful elections with a surprisingly smooth transfer of power to the new president-elect are seen as the main reason for the NBU's decisiveness in easing monetary policy. Sliding global prices for natural gas, which made it possible to meet IMF requirements on household gas rates, also gave reason for optimism to monetary authorities. We expect the NBU to hold the prime rate at the current level in June, while trying to get better sense of what direction the VR elections will be moving.

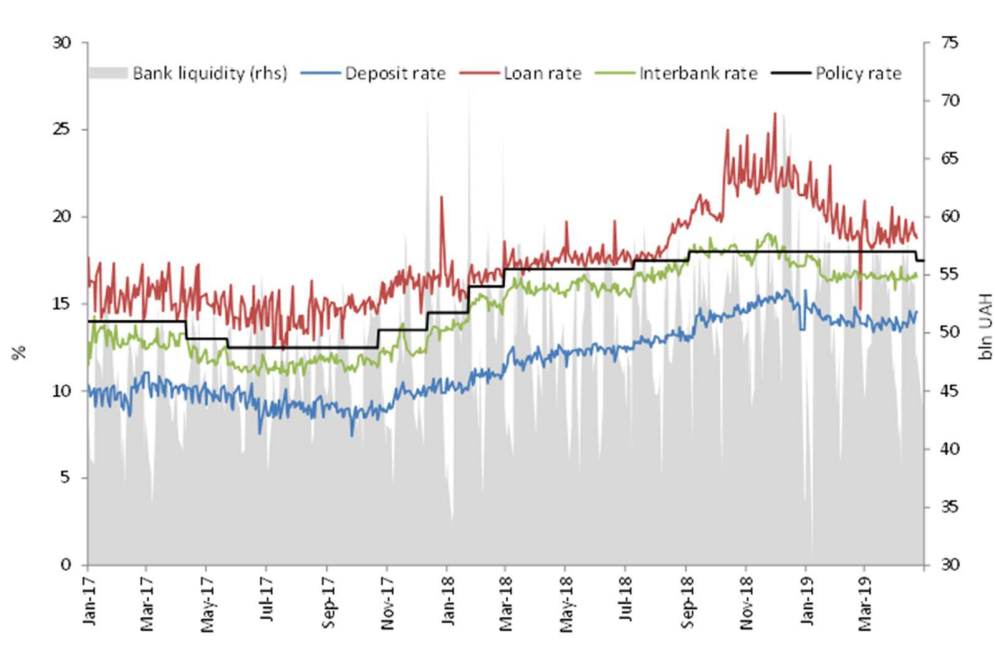
Interest rates remain high. In April, both loan rates and deposit rates inched up slightly, to 19.1%

from 18.9% in March, and 13.9% vs 13.8% in March. Most likely high demand for state bonds from non-residents and borrowing activity at the MinFin are keeping rates elevated.

The monetary base is sliding, down -2.8% ytd by March, on the back of contracting net government claims: -15.2 ppt for March. The budget is facing difficulties with tax collections, and has been withdrawing substantial resources from the market. Monetary accounts reflect this trend.

GRAPH 7

Daily average interbank rate, hryvnia loan and deposit rates (%), bank liquidity (billion UAH), 2017-2019



Source: National Bank of Ukraine

Fiscal accounts: revenues slow, while outlook raises concerns

Fiscal revenues slowed to 5.3% y/y in March, from 23.7% y/y in February. A falling-off in collections from the customs clearance of used cars was the main reason behind the tax decline in March. In February, the grace period for legalizing cars imported under semi-legal schemes ended, spurring abnormally active excise and VAT payments in February. No such payments arrived in March.

We are not worried, though, by the slowdown in March revenues: general budget revenues grew 10.4% y/y, still above the target of +9.8% y/y for the year, unless disturbing interim reports on central budget revenues arrive in April. In April, the NBU wired UAH 47.6 billion in dividends to state coffers, which allowed MinFin to report an 18.2% y/y surge in central budget collections. However, net of the NBU funds, central budget tax revenues were a mere 6.7% y/y, much below the target. To make matters worse, in April the NBU wired to the budget all dividends anticipated for the entire year, with just one payment, meaning that there are no reserves left on this item for the rest of the year.

These numbers provide a disturbing outlook for fiscal accounts. A recovery in petrol imports might improve these numbers. Still, that was a poor performance, considering it's more than three years since crisis of 2014-2015.

So far, the budget deficit looks fine. In March, the general budget was reported to be only UAH

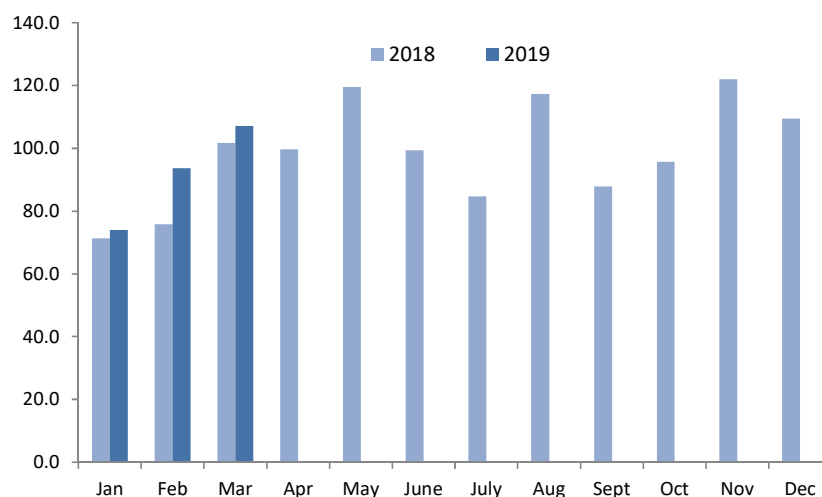
13.7 billion, or 0.4% of GDP in the red, with the central budget's UAH 12.7 billion shortfall driving the deficit. For March, the general budget deficit was a bit lower: UAH 9 billion, with the central budget deficit UAH 26.2 billion of that. However, if disturbing revenue trends continue, the picture is likely to change for the worse.

Payroll tax collections grew 21.8% y/y in March and 23.2% y/y for 3m19. Unlike last year, payroll tax collections are growing well above the targeted 14.3% y/y increase for 2019.

Against the backdrop of poor revenues, MinFin continued aggressive T-bills placement, in both hryvnia and foreign currencies. In March, the Finance Ministry attracted UAH 22.7 billion, \$159.8 million and €5.4 million. In April, MinFin raised UAH 33.9 billion, \$416.6 million and €2.6 million on the market. Due to active bond placements and the NBU dividends, MinFin has managed to stash UAH 36.9 billion on the Treasury account as of May 2nd, a record high of residuals for the last two years.

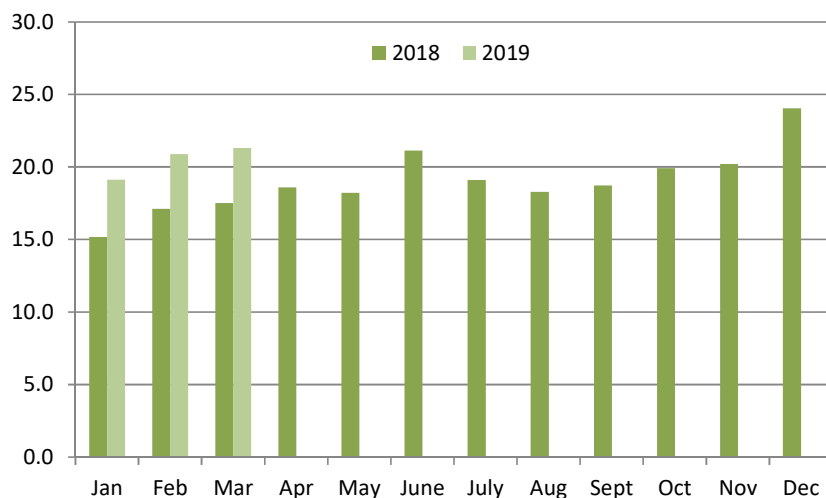
Interest rates for UAH-denominated instruments dropped slightly, but still remain above 18%. Interest rates for dollar-denominated bonds increased above 7% through March and April vs 6.6% on average in February.

GRAPH 8
General Budget Revenues, monthly, bln of UAH



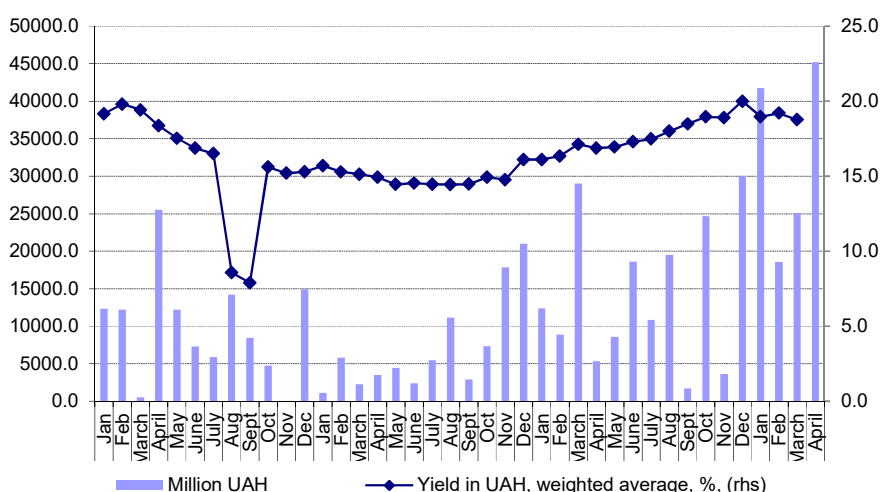
Source: Ministry of Finance of Ukraine

GRAPH 9
Payroll tax collections, billion UAH



Source: Ministry of Finance of Ukraine

GRAPH 10
T-bills issue and yield in UAH



Source: Ministry of Finance of Ukraine

External accounts improve amid surprise decline in petrol imports

External accounts are performing much better than initially expected. By March, the CAD was reported at \$422 million, down from a \$525 million deficit a year ago. An almost flat trade deficit of \$2 billion for Q1 2019, vs. \$1.94 billion a year ago, a steady increase in transfers from abroad, to \$2.95 billion from \$2.72 billion in Q1 2018, as well as a decline in coupon payments on Eurobonds—down to \$444 million in March vs. \$562.3 million a year ago—are behind this improvement.

The trade deficit has remained almost unchanged since the beginning of the year. Stronger exports of foods, up +19.9% y/y by March, coupled with a 5.7% y/y drop in energy imports on the back of the decline in petrol imports kept the trade deficit from expanding. Remarkably, natural gas

imports were on the same level as a year ago: 1.6 bcm by March.

This trend is moving in contrast to our expectations. If sustained, weaker imports amid recovering food exports promise to shave up to \$1 billion off the projected CAD, which we estimated at \$6 billion, or 4.2% of GDP for 2019.

Still the story behind the sudden plunge in petrol imports stems from a new “oil maneuver” by Russia against Belarus, caused by tainted Russian oil supplies moving through the Belarusian part of the Druzhba pipeline. This means oil supplies will recover sooner or later, with a subsequent impact on the trade balance. What’s more, a strong grain harvest in 2018 alone was not enough to keep the trade deficit from expanding, given that metal exports have been sliding steadily. Put differently, the current improvement of external accounts does not look sustainable. We expect the CAD to widen this year.

The financial and capital account balance also improved, rising to a \$758 million surplus by March, vs. \$253 million a year ago. The result was mainly achieved at the expense of a \$1.3 billion surplus in March, stemming from a €512 million loan under World Bank guarantees, the reduced foreign currency share of bank assets, down to \$890 million in March, and mounting trade credits, at \$301 million net through the month. FDI has been increasing so far: \$798 million by March vs. \$453 million a year ago. Individual cash withdrawals from the banking system also increased somewhat, but were still relatively modest for pre-election months: \$659 million by March, vs. \$446 million a year ago.

Positive trends have made it possible to maintain gross international reserves at a high level: at \$20.5 billion, or 3.4 months of imports, by the end of April.


With a better situation around natural gas prices due to global trends, Ukraine met the IMF requirement for gas rates, so we are positive about the IMF’s next review. Unless the new president delivers some surprises, we also expect successful Eurobond placements throughout the year. We expect Ukraine to have nearly \$20 billion in gross international reserves, or 3.1 months of imports, by the end of 2019. 

TABLE 2
Balance of payments and official reserves, million USD

	Jan 2019	Feb 2019	Mar 2019	
Current Account	527	-299	-650	
Balance of Goods and Services	-168	-1040	-805	
Exports	4 943	4 737	5 225	
Imports	5 111	5 777	6 030	
incl. energy imports		870	828	881
Goods (net)	-238	-1029	-836	
Services (net)	70	-11	31	
Capital and Financial Account	-595	51	1302	
Capital Account	-5	2	-8	
Direct Investments (net)	168	367	263	
Portfolio Investments (equity securities)	202	61	-57	
Other Investment	-1140	-601	1103	
incl. foreign cash return to the banking system		-87	-160	-412
Overall Balance	-68	-248	652	
Official Reserves	20 819.71	20 220.46	20 632.87	

Source: National Bank of Ukraine

Calendar of Events

MAY

May 2: Wages and salaries for March
May 7: Gross foreign reserves for April
May 8: CPI for April
May 8: PPI for April
May 17: Agriculture output for April
May 15: Trade balance for March
May 15: Trade Balance for 1Q2019
May 21: Retail trade for April
May 23: Industrial output for April
May 27: State budget revenues for April
May 31: BoP for April

JUNE

June 07: Gross foreign reserves for May
June 10: CPI for May
June 10: PPI for May
June 14: Agriculture output for May
June 14: Trade balance for April
June 19: GDP for Q12019
June 20: Retail trade for May
June 24: Industrial output for May
June 24: Employment for Q12019
June 27: Wages and salaries for May
June 26: State budget revenues for May
June 27: BoP for May

JULY

July 05: Gross foreign reserves for June
July 09: CPI for June
July 09: PPI for June
July 15: Trade balance for May
July 18: Agriculture output for June
July 22: Retail trade for June
July 23: Industrial output for June
July 26: State budget revenues for June
July 29: Wages and salaries for June
July 31: BoP for June

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