

Kyiv, 25 November 2019

## Executive Summary

- The IMF mission left Kyiv without agreeing on the new Extended Fund Facility (EFF) program, the discussions are expected to continue in the coming weeks
- The Parliament adopted the 2020 budget law
- President Zelenskyy signed the Decree on urgent measures for reforms to be implemented
- National Anti-Corruption Bureau (NABU) detained the former first deputy of the Central Bank Pysaruk
- New member of National Bank of Ukraine (NBU) Board approved
- NBU cancelled the limitations on the purchase of foreign currency and banking metals
- Ukraine ratified the agreements on avoiding double taxation with the UK, Cyprus and Malaysia, as well as the Foreign Account Tax Compliance Act (FATCA) agreement between Ukraine and the US
- Parliament adopted the farmland market bill in the first reading
- GDP slowed to 4.2% year-on-year (y/y) in real terms in the third quarter of 2019
- Ukraine's public debt (direct and guaranteed) rose 1.2% month-on-month (m/m) in September (+\$1.03bn), to USD 82.95bn
- Inflation slowed to 6.5% y/y in October as prices increase by 0.7% m/m
- Moody's changed Ukraine's outlook from stable to positive, affirming Caa1 rating
- Ukrainian grain exports up 43% y/y since the start of 2019/20 marketing year in July.
- The Parliament adopted in the first reading the bill on the regulation of amber mining
- The Parliament adopted the law "Against money laundering, financing of terrorism and financing of weapon of mass destruction (WMD) proliferation" in the first reading
- The Government representatives discussed Ukraine's economic situation, as well as the priorities for the next year

## Policy developments

### 1. The IMF mission left Kyiv without agreeing on the new Extended Fund Facility (EFF) program, the discussions are expected to continue in the coming weeks

The mission visited Kyiv on 14-22 November aiming to lead negotiations on the new Extended Fund Facility (EFF) program, which would be in force during the next three years and is about to replace the current stand-by program of USD 3.9 bn. According to the statement released at the end of the mission, the mission made significant further progress in the discussions on policies and reforms that can underpin a new IMF-supported program, including monetary, fiscal, and financial sector policies, as well as reforms to improve the business environment, strengthen the rule of law, and increase economic growth. The discussions will continue in the coming weeks, according to the IMF press release – IMF press release *Comment: From the IMF side, it is not clear yet what could be the “deal maker” for reaching the staff level*

**Exchange rate:** 24.19 UAH/\$  
(25 November)

**NBU refinancing rate:** 15.5%

**Nominal wages:** UAH 10 687 in September 2019 (equivalent to EUR 399).

**Suggested reading:** [Ukraine Special Focus Note: Land market for agricultural growth](#) by the World Bank  
[Land Reform Strategy in Ukraine until 2024](#) by VoxUkraine

**Events to watch:**  
**16 December** – parliamentary hearing on the topic of "Formation of the Efficient Intellectual Property Protection System in Ukraine"

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agreement. Two specific issues discussed include introducing safeguards against compensation to oligarchs (among others, avoiding indirect forms of compensation or indirect deal making) and clarifying current intentions with land market reform. On the safeguards, IMF has a positive assessment of the President's latest statements to withhold from any deal with the former owners of the nationalised Privatbank. IMF has preference for a broader "no compensation" principle concerning when the former Privatbank owners would be compensated via other sectors where they are economically active. On the land reform, the IMF was concerned about President's recent statements about the referendum on foreign ownership and is seeking reassurance on the intentions of Ukrainian authorities towards foreign ownership.

**2. Parliament adopted the 2020 budget law in the second reading.** On 14 November, the Parliament voted for the updated version of the 2020 budget. The bill reflects the new macroeconomic forecast of the Ministry of Economics, which implies economic growth of 3.7% y/y, inflation of 5.5% y/y and exchange rate of 27 UAH/USD. This affected a series of others calculations in the budget, namely expected revenues, expenses and the budget deficit. Other changes made between first and second readings include increase in the privatisation revenues, new expenditures in the form of grant-in-aid for municipalities, additional budget revenues from the legalization of amber mining etc. *Comment: the budget law is pending President's signature and is therefore not public. EU Delegation will share the assessment once the final version law is available.*

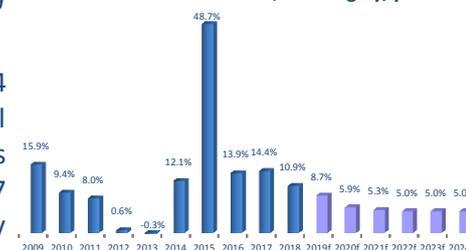
**3. On 8 November, President Zelenskyy issued a comprehensive decree containing instructions to the Government on priority reform steps within specific deadlines.** The biggest chapter of the Decree is dedicated to economic matters. By 31 December 2019, the following actions need to be completed (the list is not exhaustive): submit to Parliament legislation in order to regulate amber mining, liberalise labor relations and update Labor Code, approve action plan to raise Ukraine's score in the Doing Business rating, start large scale privatisation, in particular define 5 state-owned enterprises, prepare for the launch of the agricultural land market; prepare legislation to strengthen the IPR protection, establish supervisory boards in all State-owned banks. President set deadlines throughout the year 2020, including for the launch of the new financial investigations body and of the authorised economic operator, and for the implementation of the common transit procedure (by 31 March 2020). By end 2020, the government has to ensure the reduction of non-performing loans in the state banks' portfolios, lessen the cost of state borrowing and double the level of using IFI's funds allocated to investment projects (31 December). *Comment: many of the reform steps envisaged by the Decree are related to very complex issues. Therefore, charging the Government to take initiative in the elaboration of draft legislation in the key areas of reforms is a positive development. Such approach should help streamline the Government policy and could possibly help reduce the number of contradicting legislative initiatives from MPs, the so-called "legislative spam". Yet, short deadlines set for a number of reforms seem too tight.*

**4. National Anti-Corruption Bureau (NABU) detained the former first deputy of the Central Bank Pysaruk.** On 12 November, the eve of the IMF mission's arrival in Kyiv, the National Anti-Corruption Bureau of Ukraine (NABU) arrested Oleksandr Pysaruk, the newly appointed chairman of Austrian-owned Raiffeisen Bank Aval, who is also a former IMF staffer and former First Deputy Governor of the National Bank of Ukraine (NBU). The IMF has been pushing for the pursuit of former bank owners to recover assets lost to the state during the 2014-2015 banking crisis. Pysaruk is accused of responsibility during his time as First Deputy NBU Governor (2014-2015) and in particular while acting as Governor during a three-day period in 2014, for an emergency loan of over USD 50 million to VAB Bank shortly before the bank was closed down. The collateral for the loan was real estate that was allegedly valued

GDP, real % growth y/y



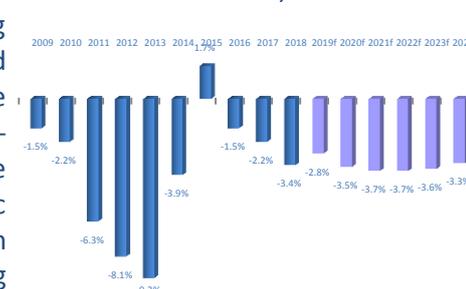
Consumer Price Index, % change y/y



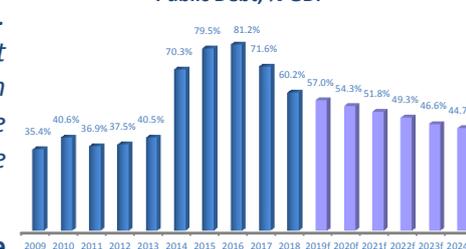
Consolidated Budget Balance, % GDP



Current Account, % GDP



Public Debt, % GDP



Official FX Reserves, bn USD



Sources: Ukrainian State Statistics Service, National Bank of Ukraine, IMF

falsely at 25 times its real value and the money was never recovered. Pysaruk is being investigated by NABU along with two other former NBU officials and five former VAB Bank executives. Current and former NBU Governors Smoliiy and Gontareva, along with European and American business representatives, have rallied behind Pysaruk, defending his impeccable reputation as a banker and his significant previous role in Ukraine's banking sector reform. *Comment: The arrest of one of Ukraine's most respected banking industry representatives and former IMF staffer Oleksandr Pysaruk on the eve of the IMF visit provoke substantial controversy, not least in its remarkable timing and the negative reaction it has generated from the banking and business communities. Along with former NBU Governor Gontareva, Mr Pysaruk is said to have played a key role in the cleaning up of Ukraine's banking sector following its 2014-2015 crisis.*

**5. The Parliament adopted the Decree on changes in the composition of the National Bank of Ukraine's Board.** According to the Decree, the new member of the Board would be Vitalii Shapran – financial analyst, former Director of the Rating Committee of the Ukrainian Professional Association for Protection of Investors, Creditors and Insurants, member of the Expert Council of the Deposit Guarantee Council.

**6. NBU cancelled the limitations on the purchase of foreign currency and banking metals.** On 29 September, the National Bank of Ukraine cancelled the limitations on the purchase of foreign currency and banking metals, which were previously equal to UAH 150 thousand per day (in the equivalent). Besides, NBU also cancelled the requirement for submitting the documents proving the reason for purchasing the foreign currency. The institution expects that the policy would not have a significant effect on the foreign exchange market, as a bigger part of operations at the market does not exceed the limit. Besides, according to the latest surveys of the NBU, the inflation and devaluation expectations continue to improve, which is why there are no reasons for the pressure on hryvnia. The policy is the part of the capital market liberalization, in the framework of which NBU already cancelled over 30 currency limitations during 2019 – National Bank of Ukraine

**7. Ukraine ratified the agreements on avoiding double taxation with the UK, Cyprus and Malaysia.** The Parliament adopted a number of bills ratifying the Agreements with the UK and Malaysia on avoiding double taxation and preventing tax evasion, as well as making changes to the existing respective agreement with Cyprus. This contributes to the improvement of economic relations between the countries – Ministry of Finance

**8. The Parliament ratified the Foreign Account Tax Compliance Act (FATCA) agreement between Ukraine and the US.** The Parliament of Ukraine ratified the Agreement between the Government of Ukraine and the Government of United States to improve tax compliance and the application of the US Foreign Accounts Tax Law, as well as related draft laws No. 2102 and No. 2103. The Agreement was signed in February 2017 and required the amendments to Ukrainian legislation, which were approved in the Rada. In particular, draft laws No. 2102 and No. 2103 provide grounds for implementation of internal reporting and the automatic provision of information to the US State Tax Service on accounts opened by US taxpayers in Ukrainian financial institutions. The automatic exchange of information will be unilateral, but Ukraine will be able to consult with the United States on amendments to the Agreement for the bilateral exchange of information, according to the Ministry of Finance – Ministry of Finance

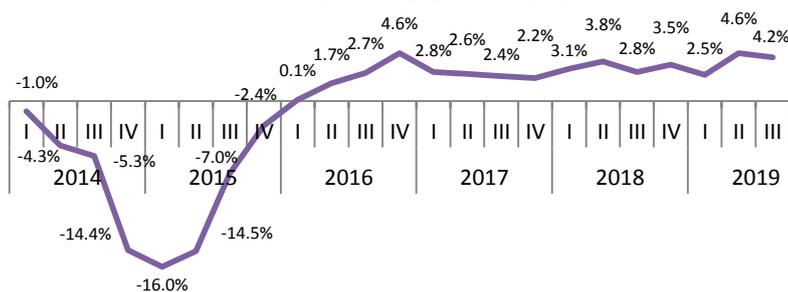
**9. Parliament adopted the farmland market bill in the first reading.** On 13 November, after five-hour debate, Parliament adopted bill #2178-10 on the farmland market regulation. 240 lawmakers (14 more than the necessary limit to pass) supported the legislation, most of them from the ruling party (227 votes), 13 votes were from unaligned MPs. All other Rada factions either voted against or abstained. The approved bill was an alternative to the governmental bill and was created by Rada's agricultural committee. It bans companies with foreign founders from buying farmland until 2024 while making an exemption for existing foreign-owned land operators. The bill also proposes tighter limits on land concentration per entity, setting regional caps at 8% of the total land bank (vs. 15% in the original government-drafted bill) and introducing an additional cap of 35% across local communities. However, the legislation may be changed between the first and second reading reflecting the commitment of the President to allow the foreign ownership only in the case of getting the approval from the population via referendum – *Dragon Capital Comment: The initial approval of the land reform law has been so far the most socially and politically significant act of the new Parliament. The sale of agricultural land has been under 'temporary' moratorium since the adoption of the Land Code in 2001 and populist forces obstructed any attempt to solve the issue. The ruling party has now a unique momentum for adopting this legal package and ensuring that the general terms of a fair land market reform are put in place.*

## Macroeconomic developments

**10. Ukraine's GDP slowed to 4.2% y/y in real terms in the third quarter of 2019 (after 4.6% y/y in 2Q2019).** Seasonally adjusted GDP was up by 0.7% q/q, decreasing from 1.6% q/q in 2Q2019. The GDP growth for the 9 months 2019 reached 3.9% y/y.

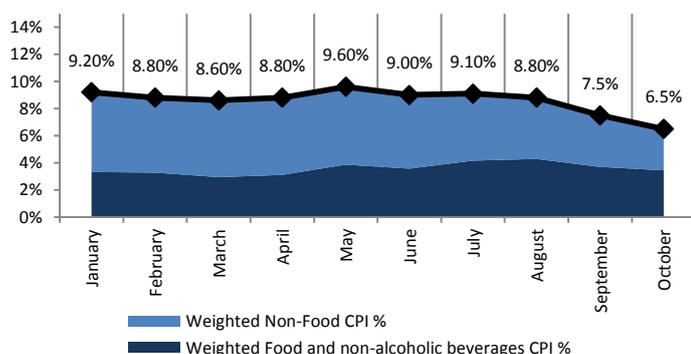
*Commentary: according to the Ministry of Economic Development, the growth was driven by external and domestic demand (both consumption and investment). The consumer demand in turn was supported by the wages increase (for 9 months, real wages increased by 9.5%) increase in consumer credits (according to the NBU, the volume of the loans to households increased by 19.3% for nine months 2019) and increase in consumer sentiment index (97.5 comparing to 62.6 in September 2018, according to Info Sapiens agency). From the production side, the high growth remained present in the agricultural sector, driven by high yields of sunflower and corn (est. 5.9% y/y in 3Q2019 on a bumper grain harvest). On the other hand, according to NBU, the slow-down in the GDP growth was driven by the worsening situation in the industry sector, due to less favourable external environment for exporters (sector output dipped an est. 0.4% y/y in 3Q19). All in all, the 3Q2019 GDP real growth was higher than expected at 4.2% y/y (vs 3.5% growth forecast by the NBU and the majority of other economists). According to Dragon Capital, the stronger than expected 3Q19 GDP print suggests that full-year growth will be closer to 3.5% y/y, exceeding the current forecast of 3.2% y/y – Ministry of Economic Development, Agriculture and Trade (META), National Bank of Ukraine, Dragon Capital*

GDP real quarterly growth, y/y, %



**11. Ukraine's public debt (direct and guaranteed) rose 1.2% m/m in September (+\$1.03bn), to USD 82.95bn.** The increase was driven by the rise in the internal debt, particularly in the UAH-denominated component, which surged by USD 2.42 bn (+7.5% m/m) on account of foreign inflows into domestic UAH bonds, as well as by hryvnia appreciation (+4.8% m/m to UAH 24.1 USD). Thus, it is worth noting that the public debt in the national currency decreased by 3.3% m/m. F/X-denominated debt remained on a downward trend in September due to \$1.4bn of external debt redemptions which was only partially offset by a \$0.5bn net placement of domestic F/X bonds – Dragon Capital, Ministry of Finance

Consumer Price Index 2019, y/y, %



Official FX Reserves in 2019



**12. Inflation slowed to 6.5% y/y in October (from 7.5% y/y in August), as prices increased by 0.7% m/m.** Core inflation, an indicator adjusted for regulated utility tariffs and prices of raw foods and energy, rose 0.7% m/m after a 1.2% increase in August and slowed to 5.8% y/y from 6.5% in September. The slow-down was driven by lower than expected growth in vegetable prices (23% y/y), alcohol and tobacco prices. *Commentary: the inflation was also influenced by hryvnia appreciation in October (currency was 13% y/y stronger), continued decline in fuel prices (-14% y/y in October vs. -8.2% y/y in September) and correspondingly lower transportation costs, as well as a further drop (for the sixth consecutive month) in retail natural gas prices. The headline CPI hit the lowest record since March 2014 and came close to the NBU's target band of 4-6% - Dragon Capital*

**13. Moody's changed Ukraine's outlook from stable to positive, affirming Caa1 rating.** On 22 November, Moody's Investors Service updated the outlook on the Government of Ukraine's ratings to positive from stable. Ukraine's long-term issuer and senior unsecured ratings were affirmed at Caa1. Among the drivers of the update are increase in the

foreign exchange reserves, improvements in macroeconomic stability and others. At the same time, according to Moody's the Caa1 rating reflects Ukraine's significant external vulnerability – Interfax Ukraine

## **Sectoral Developments**

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**14. Ukrainian grain exports up 43% y/y since the start of 2019/20 marketing year in July. 2019 harvest forecasts report new record high (expected total harvest of around 74 Mt).** Total harvest stood at 62 Mt as of 24 October, up 14% y/y, while grain exports increased by 43% y/y since the start of the 2019/20 marketing year in July. According to Economy and Agriculture Minister Tymofiy Mylovanov, his agency forecasts the 2019 grain harvest at 74 Mt, up 4 Mt y/y; it includes 28 Mt of wheat, 35 Mt of corn and 9 Mt of barley and 14.2 Mt of sunflower. Similar forecast is reported by Dragon Capital – with upside potential of about 5% to the current 2019 grain harvest forecast of 70.5 Mt (+1% y/y), implying a total harvest of around 74 Mt, up 6% y/y and a new record high. – Dragon Capital

**15. Parliament adopted in the first reading the bill on the regulation of amber mining.** On 12 November, the Parliament adopted in the first reading the draft bill #2240 "On Amendments to Certain Legislative Acts of Ukraine on Regulation of Amber Mining". The bill published on the Rada web site includes a temporary ban (until 1 January 2021) on exports of non-processed amber. According to the part 1 of the law, provision 5: "... Temporarily, by 1 January 2021, it is prohibited to export out of customs territory of Ukraine in the customs regime of exports the raw (unprocessed) amber, sorted by fractions or unsorted".

**16. The Parliament adopted the law "Against money laundering, financing of terrorism and financing of WMD proliferation" in the first reading.** The law is expected to be updated between the first and the second readings and reviewed at a Parliament session in the beginning of December. There exists a need to finalise updates in a way that would facilitate an effective fight against money laundering and terrorist financing. Adoption of this law is a pre-condition to disbursing the second tranche of the macro-financial assistance and remains to be fulfilled.

**17. The government representatives discussed Ukraine's economic situation, as well as the priorities for the next year.** On 19 November, representatives of the Government participated in the panel discussion at the Annual General Membership Meeting of European Business association. In particular, Minister of Finance stated that the year of 2020 will be the year of launching the three-year state budget planning system, which would be delivered by next summer, as well as the year of finishing customs, tax and decentralization reforms. The Head of the National Bank Smolii expressed the commitment of the NBU to develop the programme of financial sector activities till 2025, where there would be indicated the priorities of the NBU activities with their key performance indicators, as well as to continue the cooperation with the IMF. Minister of Economic Development Mylovanov revealed the five priorities of the Ministry: farmland market opening, real sector and privatization, labour market, export promotion and competition. The Head of the Customs Service Nefiodov committed to his plan to fight the corruption at customs and stated that there would be significant employees' dismissals in place before the launch of the Customs Service in two weeks; besides, Nefiodov committed to fight contraband, dark and grey imports and stated that the average customs value of non-raw imports this month was the highest of two-year period, which might be an indicator of less corruption at customs.