



## UKRAINE

### Highlights

- **Economic growth remained resilient despite pressures from the twin election cycle.** After a slight moderation in gross domestic product (GDP) growth from 3.3 per cent in 2018 to 2.5 per cent in the first quarter of 2019, the economy accelerated to 4.6 per cent growth in the second quarter of 2019.
- **Foreign portfolio inflows have increased significantly.** Investors have been attracted by restored macroeconomic stability and sound central bank policies, along with favourable conditions on international financial markets.
- **Reform progress has been mixed.** Financial-sector and public finance reforms have continued as planned, but anti-corruption efforts suffered a setback, while the launch of an ill-prepared electricity market reform has asymmetrically hit industrial electricity consumers and disrupted the payments of feed-in tariffs to renewables.

### Key priorities for 2020

- **Ukraine needs to preserve macroeconomic and financial-sector stability.** The National Bank of Ukraine (NBU) has played a crucial role in restoring macroeconomic stability and overhauling the banking sector. Its independence has to be respected and its decisions in the banking sector accepted as irreversible.
- **The authorities should speed up implementation of reforms.** Cooperation with the International Monetary Fund (IMF) on a new reform-focused programme is vital. Key reforms should include: unbundling of the gas transmission system operator from Naftogaz together with the establishment of the gas exchange; land market reform; commercialisation and privatisation of state-owned enterprises (SOEs) and state-owned banks (SOBs); fighting against corruption; judicial reform; and digitalisation of public-sector services.
- **Legal obstacles to reforms should be tackled urgently.** Following opinions from the Constitutional Court of Ukraine on the illegal enrichment provisions in the criminal code and the establishment of the electricity market regulator, the parliament should amend the Constitution of Ukraine to enable provisions compliant with the country's international commitments.

#### Main macroeconomic indicators %

	2015	2016	2017	2018	2019 proj.
GDP growth	-9.8	2.4	2.5	3.3	3.3
Inflation (average)	48.7	13.9	14.4	10.9	8.7
Government balance/GDP	-0.9	-2.1	-1.2	-2.1	-1.5
Current account balance/GDP	1.8	-1.4	-2.2	-3.3	-2.8
Net FDI/GDP [neg. sign = inflows]	-3.3	-3.5	-2.3	-1.8	-1.9
External debt/GDP	129.3	120.5	102.9	87.7	n.a.
Gross reserves/GDP	14.6	16.6	16.8	15.9	n.a.
Credit to private sector/GDP	49.4	41.9	34.1	30.2	n.a.

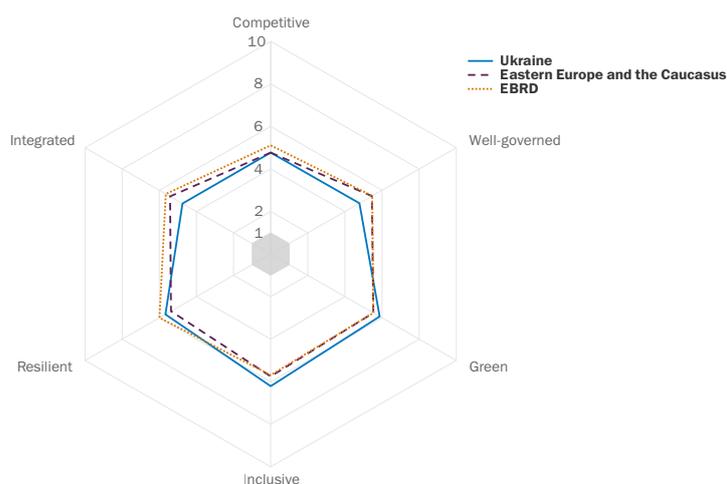
### Macroeconomic performance

**GDP growth has accelerated.** The growth rate of the economy rose from an average of 2.5 per cent in 2016-17 to 3.3 per cent in 2018. Improvement in 2018 was driven by robust growth in household consumption and domestic investment in fixed assets. The strong real wage recovery, as well as an increase in the average pension and a rise in the inflow of remittances all supported household consumption, which grew by 8.9 per cent. Exports of goods and services declined by 1.6 per cent, while imports increased by 3.2 per cent in real terms. GDP growth remained at 3.3 per cent year-on-year in the first half of 2019 notwithstanding the challenging environment. Among the expenditure components, the growth of household consumption accelerated to 11.3 per cent driven by continued strong growth of real income and growth of fixed investments increased by 12.0 per cent, benefiting from strong construction activity. Government consumption declined by 7.3 per cent. Exports and imports both recorded solid real growth of 5.6 and 7.8 per cent, respectively.

**Macroeconomic stability has strengthened in 2019.** Inflation has slowed to 7.5 per cent in September 2019 but remains higher than the 5.0 per cent target of the NBU. Positive developments allowed the NBU to start the loosening cycle by reducing the key policy rate from 18.0 per cent in April to 15.5 per cent in October. The NBU's credible monetary policy, coupled with high real interest rates, favourable conditions on international financial markets and an enabling settlement of domestic securities on Clearstream, have all helped attract significant foreign private capital inflows on the domestic government securities market. In addition, in mid-June 2019, the Ministry of Finance issued a €1 billion seven-year Eurobond at 6.75 per cent, followed in July by US\$ 1.5 billion at slightly higher rates by Naftogaz and Ukrainian Railway. The abundance of foreign portfolio capital inflows led to a 15.0 per cent appreciation of the local currency to the US dollar from January to September 2019. Such inflows also helped to increase foreign reserves to US\$ 21.4 billion at the end of September 2019, despite large debt repayments in the same period.

**Economic growth is likely to stabilise in the short term.** GDP growth is expected to be 3.3 per cent in 2019 and 3.5 per cent in 2020. Bearing in mind that Ukraine has significant foreign exchange public debt liabilities (including SOEs and domestic foreign exchange treasuries) in the next 24 months, IMF support is of crucial importance for anchoring investors' expectations.

#### Assessment of transition qualities (1-10)



## Major structural reform developments

**Foreign exchange market liberalisation has continued.** Satisfactory macroeconomic conditions have enabled the NBU to continue liberalising the foreign exchange market in accordance with the Law on Currency and Currency Operations, which entered into force in July 2018. Over 30 foreign exchange market restrictions were cancelled in the first six months of 2019. These restrictions include: abolishing the mandatory foreign exchange conversion requirement for exporters (exchange of foreign currency receipts to local currency); cancelling all limits on repatriation of dividends and proceeds from selling securities and equity rights; lifting the limit on funding foreign representative offices of Ukrainian businesses; replacing individual NBU licences with a general cap for certain cross-border payments; abolishing cross-border loan registration and the cap on the cost of funding; and removing restrictions on foreign currency purchases with loan funds.

**Financial-sector supervision was strengthened.** New legislation, the so-called “split law” adopted in September 2019, divided financial-sector regulation and supervision between the NBU and the National Commission for Securities and Financial Market (NCSFM). In addition to regulating the banking sector, the NBU also became a regulator of the insurance sector, as well as leasing, financial companies, credit unions and pawn shops. The NCSFM will regulate private pension funds and building societies.

**The process of harmonisation and integration with the international financial infrastructure has advanced.** In May 2019, the Ukrainian market connected to Clearstream, the international central securities depository, a step that enabled settlement of all government bonds denominated in local currency through the international system. This move has improved efficiency, reduced costs for investors and increased demand for Ukrainian government bonds issued on the domestic market. As of 5 August 2019, banks have started to open new customer accounts in line with the International Bank Account Number (IBAN) system, which will harmonise the Ukrainian payment landscape with that of the European and contribute to the further planned upgrade of the NBU's system of electronic payments. In general, the use of the IBAN standard with fewer payment details is intended to simplify the drafting of payment documents. All transfers will use IBAN from 1 November 2019.

**Fiscal administration and accountability are being improved.** In March 2019, the State Fiscal Service of Ukraine was split into two separate executive bodies: the State Tax Service and the State Customs Service. The main goals of the reorganisation were to create a function-based revenue administration, to increase the transparency and accountability of both institutions and to improve the quality of services. The Ministry of Finance strengthened its supervisory and control functions by implementing a system of reporting requirements and key performance indicators.

**Corporate governance reform in SOBs has entered a new phase.** A law on improving the functioning of the financial sector, signed by the President in October 2018, enabled the implementation of governance changes in SOBs. Following a competitive selection process, supervisory boards of three state-owned banks (PrivatBank, Ukreximbank and Oschadbank) were appointed in May 2019 and confirmed by the Cabinet of Ministers. However, in line with its legal right and based on the assessments of compliance with the qualification criteria, the NBU rejected a number of candidates for the supervisory boards in Oschadbank and Ukreximbank in August 2019. Vacant positions remain to be filled in the coming months.

**Electricity market liberalisation has commenced but is facing obstacles.** Liberalisation began on 1 July 2019. Unfortunately, shortly before that date, on 13 June 2019, the Constitutional Court of Ukraine ruled that a number of provisions of the Law “On Sector Regulator (NEURC)” contradict the constitution of Ukraine, and will need to be brought into compliance with the constitution by 1 January 2020. The parliament has launched the process of amending the constitution, but such amendments cannot be approved and enter into force before February 2021, leading to the ambiguity of the status of the NEURC for a period of a few months.

**New legislation has introduced an auction system for “green energy” power plants.** The introduction of competitive conditions for building power plants that produce electricity from renewable sources is in line with the international trend of making the process more competitive, controllable and cost-effective. From 2020, auctions will be compulsory for newly developed solar power plants with a capacity of more than 1 MW and wind farms with a capacity of more than 5 MW.

**Anti-corruption reforms have experienced a setback.** In February 2019, the Constitutional Court of Ukraine declared the Criminal Code article that criminalises illicit enrichment of public officials to be unconstitutional. This is a setback from the previous reform. The effect of the decision was retroactive, effectively dismissing all cases investigated by the National Anti-Corruption Bureau or those that were examined in courts. The norm on liability for illegal enrichment, adopted in 2015, was among the preconditions both for receiving a visa-free regime from the European Union and for the previous programme with the IMF. The President submitted to the parliament a draft law aimed at reinstating the criminal nature of illicit enrichment, in accordance with Ukraine’s constitution and the country’s international commitments.

