ІНСТИТУТ ЕКОНОМІЧНИХ ДОСЛІДЖЕНЬ
ТА ПОЛІТИЧНИХ КОНСУЛЬТАЦІЙ
INSTITUTE FOR ECONOMIC RESEARCH
AND POLICY CONSULTING

Monthly Economic Monitor Ukraine

No.1
October 2000

- The Ukrainian economy kept growing for the 9th month in a row. The GDP increase is expected to reach 3.2% in 2000, but a slowdown next year seems likely.
- In the light of continuing good export performance, the current account could post a surplus of 2.5% of GDP in 2000, yet import growth is likely to outpace exports in the months ahead for seasonal reasons.
- In view of the good budget performance a balanced budget is achievable in 2000. The budget for 2001 was adopted by Parliament in first reading, a slight deficit is likely because assumptions seem too optimistic.
- The inflation rate could stay above 30% until the end of the year. In 2001, a more restrictive monetary policy could result in a slowdown in the price increase.
- The Hryvnia exchange rate remained stable due to National Bank interventions in the inter-bank market. A controlled nominal depreciation is expected to avoid a further real appreciation.

Population: 49.4 m
Industry/GDP: 40%
Agriculture/GDP: 12%
Investment/GDP: 20%
Export destination: Russia 33%, EU 10%
Import origin: Russia 50%, Germany 20%

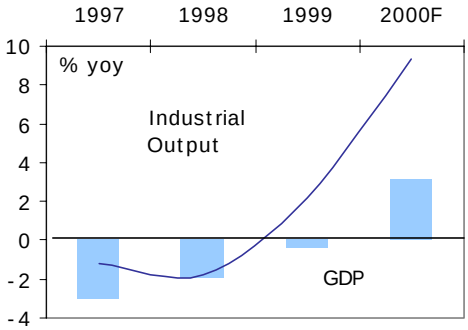
Politics: Without further reforms growth is in danger

Despite the present economic upturn, the long-term success of economic developments in Ukraine will depend on further structural changes and liberalisation. In particular, more attention must be paid to the reform of the legal system, to corporate restructuring and competition policy. Also reforms of intergovernmental relations and of the financial sector should be consistently pursued. The European Commission recently granted Ukraine the status of a market economy with regard to Ukraine's efforts to join the WTO. This will prevent anti-dumping investigations against Ukrainian industries. Resumed lending from the World Bank has raised hopes about the resumption of IMF lending and can be seen as a positive appraisal of the present financial stability and punctual external debt service.

Real economy: Will the boom continue?

Despite some concerns about the low statistical base in the first half of 1999 the Ukrainian economy kept growing for the 9th month in a row since January 2000. In September real GDP grew by 3.2% compared to September last year or by 5% since the start of the year, which represents a slight slowdown compared with August (7.5% yoy, 5.3% cum.). On the production side, the major source of growth is a steady increase of industrial output (8.2% yoy in September), mainly in the light and heavy export-oriented industries which was fuelled by an expansionary monetary policy and higher than expected inflation. On the expenditure side, reduction of wage arrears (by 8.9% between the beginning of 2000 and mid-September) and growth of real wages (by 7.9% in 1H2000) promoted private consumption which is – alongside net exports – the main source of growth. As a result,

Real Output Growth



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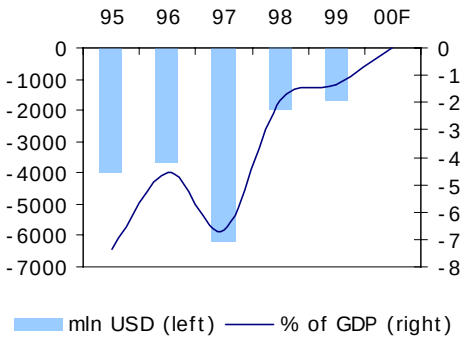
our estimation for GDP growth in 2000 is 3.2%: the first positive growth rate since independence.

However, growth could slow in 2001 as the potential for further industrial growth decreases because of slow industrial restructuring, persistent problems in the energy sector and insufficient foreign investment into important industries. National Bank plans to tighten monetary policy and a decreasing growth contribution of net exports prevent higher growth rates.

Consolidated Budget Deficit



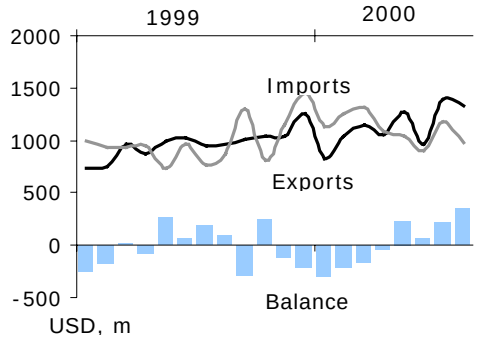
Sectoral trends: Privatisation pushed ahead

The privatisation of six regional power distribution companies (Oblenergos) and of the Ukrainian telecom (Ukrtelecom) have become more concrete in the past months. The French EDF and the American AES have expressed an interest in the Oblenergos. Next year's privatisation of 25% of Ukrtelecom is expected to generate about USD 250-500 m. But there is a high probability that the planned privatisation will not have been completed.

Russia's Gazprom and major western companies have set up a consortium to build a 600-kilometre long natural gas pipeline to Western Europe bypassing Ukraine. In reaction to the new pipeline Parliament proposed to privatise 49% of the Ukrainian pipeline system. The Government insists on a concession scheme with possible Russian participation. Russian Gazprom voiced its intention to obtain majority control of the transit facilities.

As part of the agricultural reforms started in December 1999 the new Land Code introducing private ownership for agricultural land is expected to be adopted within the coming weeks. Agricultural output in the first nine months was about 1% higher than in the previous year despite shortages in input supplies and despite the restructuring caused by the recent reforms. For the coming year the value of agricultural production is expected to be slightly higher as current reforms start to take effect.

Exports and Imports



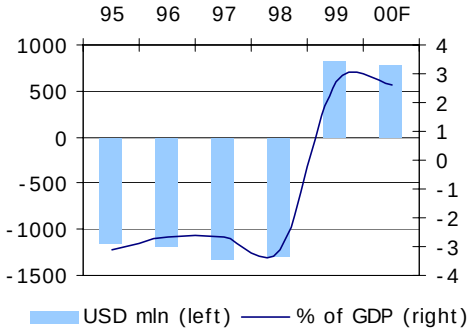
External sector: Foreign trade and FDI growing fast

In August Ukrainian merchandise exports and imports both increased by some 24% on a yearly basis. The main reasons are demand expansion due to strong economic growth of major trading partners as well as the Hryvnia's past devaluations. By the end of the year, imports are expected to grow faster for seasonal reasons, recording 27% on a yearly basis, and exports should stabilise at the present level because of lacking domestic industrial capacity and non-tariff barriers (especially in the EU) for hot rolled metals and textiles. The surplus in the trade balance is however expected to reach USD 750 m this year. The current account could post a USD 680 m surplus. Apart from pure volume increases, there are also qualitative improvements in the external sector. One of them is an increase in the share of finished goods in export and import to 11.7% and 0.7% respectively.

In our view next year's current account surplus is about to shrink significantly due to rising imports of investment and consumer goods on the one hand, and to limited capacities for further export expansion and a growth slowdown in Russia on the other. The real appreciation of the Hryvnia in 2000 will also play a role by eroding the price competitiveness of Ukrainian enterprises.

In the first two quarters foreign direct investment (FDI) inflow increased to USD 339 m (i.e. 112%) compared with last year. However, Ukraine still has one of the lowest ratios of FDI to GDP of all transition economies. By the end of 2000 FDI is expected to reach 600 m. It could grow next year substantially due to the privatisation of the Ukrainian telecom (Ukrtelecom) and a number of regional energy distribution companies.

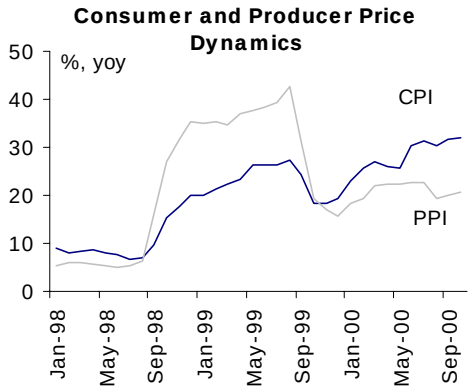
Current Account Balance



Fiscal policy: Current budget still in surplus

The Government could well be able to reach its target of a balanced budget in 2000. Yet the Government will have to reduce expenditures leading to an accumulation of budget arrears and an increase in the deficit on a commitment basis. During the first nine months of 2000, the consolidated budget surplus amounted to about 1.2% of GDP – mainly due to strong growth and the under-financing of expenditures.

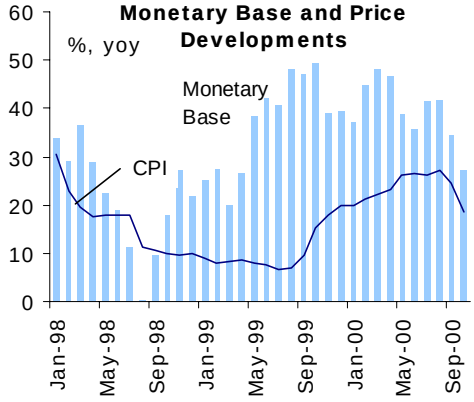
Parliament adopted the budget for 2001 in first reading, but some changes are likely to be made, especially in social policy. The draft assumes a balanced budget, but over-optimistic budget planning has the potential to create a deficit. If one assumes tax privileges to continue, slower GDP growth and difficulties with cutting budget expenditures, a slight consolidated budget deficit can be anticipated for 2001. This deficit is likely to be financed by domestic bond issues, provided the debt market revives.



Price developments: Money creation fuels inflation

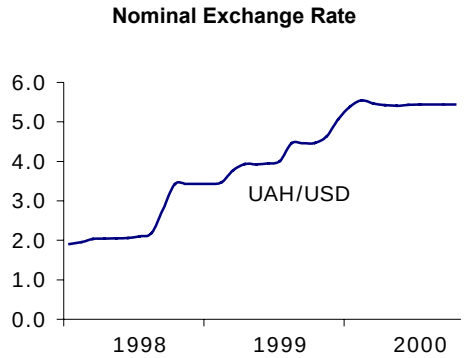
The net purchases of USD by the National Bank this year (totalling about USD 1.1 bn) were primarily used for external debt payments. Yet they have led to substantial money creation which has only partially been sterilised. Consequently, reserves have remained more or less unchanged (USD 1.1-1.2 bn), but the inflation rate rose to 28-29% on average. On a monthly basis prices rose again by 2.6% in September compared with stable prices in August. This was caused by higher foodstuff and fuel prices and by excessive liquidity of the commercial banks. In view of the 31.7% yoy price increase in September, CPI inflation will stay high until the end of the year reaching around 30% yoy in December.

In 2001, the National Bank plans to adopt a more restrictive monetary policy aiming at disinflation and preventing devaluation-driven inflation. The main targets of monetary policy – under the assumption of 4% economic growth – will be: growth of the monetary base by 16%, CPI inflation of 15.4% at end of the year, and no credit to the government. The possible resumption of external financing could also ease external debt servicing and reduce pressure on the Hryvnia exchange rate. However, we expect the inflation rate to be higher than the official forecast because of inertial inflation and increases in administered prices.



Financial markets: Hryvnia stable, controlled depreciation likely

In reaction to strong exchange rate fluctuations in September and October the NBU intervened in the interbank market and managed to keep the exchange rate at around 5.44 Hryvnia/USD. The nominal stability of the Hryvnia together with high inflation resulted in a real exchange rate appreciation that could reach up to 15% by the end of 2000 and may be detrimental to next year's export performance. The NBU intends to maintain its focus on ensuring smooth exchange rate changes next year and plans to actively regulate the currency market. We expect the National Bank soon to permit a slight and steady depreciation in order to avoid further real appreciation of the Hryvnia. The Hryvnia/USD exchange rate is expected to be 5.65 in December 2000.



Economic Trends

		Q3 99	Q4 99	Q1 00	Q2 00	Q3 00	Jul	Aug	Sep	Oct
GDP growth (real)	% yoy	na	na	5.5	4.5	5.1	4.7	7.5	3.2	6.1
GDP growth (real)	% yoy cum.	-1.7	-0.4	5.5	5.0	5.0	5.0	5.3	5.0	5.1
Industrial production (real)	% yoy	6.9	7.9	6.7	7.5	...	16.1	13.7	8.2	13.5
Agricultural production (real)	% yoy cum.	-1.9	-6.9	-4.9	-4.9	1.3	-5.7	0.2	1.3	2.1
CPI	% yoy	26.0	18.7	25.1	27.4	31.1	31.5	30.2	31.7	32.1
PPI	% yoy	38.0	17.7	19.9	22.5	20.6	22.7	19.4	19.9	20.6
Exports (gs, USD)	% yoy cum.	-11.6	-7.9	24.8	16.4	...	22.6*	24.5*	24.8*	...
Imports (gs, USD)	% yoy cum.	-27.0	-19.1	19.4	19.8	...	26.1*	24.4*	17.4*	...
Merchandise trade balance	USD bn	0.23	-0.46	-0.43	0.24	...	0.21	0.35	0.25	...
Current account	USD bn eop	0.39	-0.02	-0.21	0.49	...	...	...	...	...
Current account	% GDP	4.5	-0.3	-3.5	6.8	...	...	...	...	...
Official reserves	USD bn eop	1.33	1.05	0.94	0.81	1.02	0.90	1.09	1.02	...
Monetary Base	% yoy eop	46.9	39.3	47.9	35.7	34.5	41.5	41.8	34.5	27.9
Lending rate (UAH, 30 days)	% pa, avg	50.5	52.5	35.7	31.7	32.5	31.5	30.0	32.5	...
Exchange rate	USD aop	4.46	5.07	5.47	5.44	5.44	5.44	5.44	5.44	5.44
Exchange rate	EUR aop	4.68	5.12	5.28	5.15	4.76	5.12	4.92	4.76	4.76
Eurobond spread (03/07)	bp eop	...	...	...	1083	1053	1040	983	1053	1227

**Monthly figures are for merchandise exports/imports only*

Key Economic Indicators

		1995	1996	1997	1998	1999	2000F
Nominal GDP	USD bn	37.0	44.6	50.2	41.9	30.8	31.8
GDP growth (real)	% yoy	-12.2	-10.0	-3.0	-1.9	-0.4	3.2
Industrial production	% yoy	-24.5	-0.6	-1.2	-1.7	2.2	9.3
Agricultural production	% yoy	-4.6	-9.5	-1.9	-9.8	-6.9	...
Private consumption	% yoy	-1.6	-9.2	0.5	2.0	1.5	3.0
CPI	% yoy aop	28.2	23.6	15.9	10.6	22.7	28.8
CPI	% yoy eop	181.4	39.7	10.1	20.0	19.2	29.6
PPI	% yoy aop	488.9	52.1	7.7	13.2	31.5	20.8
Exports (gs, USD)	% yoy	-0.9	23.4	0.0	-13.4	-7.9	22.0
Imports (gs, USD)	% yoy	-4.0	24.2	2.0	-14.0	-19.1	25
Terms of trade	% yoy	-6.5	2.6	6.3	1.5	-10.6	2.2
Current account	USD bn	-1.15	-1.18	-1.34	-1.30	0.83	0.78
Current account	% GDP	-3.1	-2.7	-2.7	-3.1	2.7	2.6
FDI (net)	USD bn	0.27	0.53	0.58	0.75	0.49	0.60
Official reserves	USD bn	0.9	1.9	2.3	0.6	1.0	1.2
Fiscal balance	% GDP	-7.3	-4.5	-6.6	-1.9	-1.3	0.0
Total public debt	% GDP	41.7	25.0	30.4	51.5	62.8	58.8
External debt (total)	% GDP	27.0	20.5	19.4	38.4	51.0	43.1
Monetary base	% yoy eop	132.3	38.0	44.6	21.9	39.3	29.3
Exchange rate	USD aop	1.47	1.83	1.86	2.45	4.13	5.46
Exchange rate	USD eop	1.80	1.88	1.90	3.43	5.07	5.65
Exchange rate	EUR aop	1.93	2.32	2.11	2.77	4.39	5.02
Exchange rate	EUR eop	2.34	2.36	2.11	4.02	5.12	4.97
Real exchange rate (CPI defl.)	USD, % yoy eop	65.6	28.7	7.6	-34.7	-21.5	11.9