

Monthly Economic Monitor Ukraine

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2001

- In January industrial output grew strongly at 19.5% yoy boosting the GDP to 9.1% yoy. However political instability coupled with unfavourable conditions in the international metals markets continue to present major impediments to further growth.
- The State Property Fund issued a 'for sale' list of enterprises, for each of which a 25% minimum stake is to be offered for sale in 2001. The Fund also announced a tender to select a consultant for the sale of twelve more Oblenergos.
- Six foreign investors, among them the EBRD and the German-Ukrainian Fund, have founded the Micro Finance Bank, a potentially important source for SME financing.
- FDI in 2000 was up by 20% yoy and reached USD 584 m. The merchandise trade balance showed a surplus of USD 616 m in 2000.
- The NBU started pursuing a tight monetary policy in 2001 to combat inflation. The first success was the sterilisation of UAH 948 m in January, more than in all of the year 2000.

Population: 49.4 m
 Industry/GDP: 30%
 Agriculture/GDP: 11%
 Investment/GDP: 17%
 Export destination: Russia 25%, EU 17%
 Import origin: Russia 38%, EU 21%

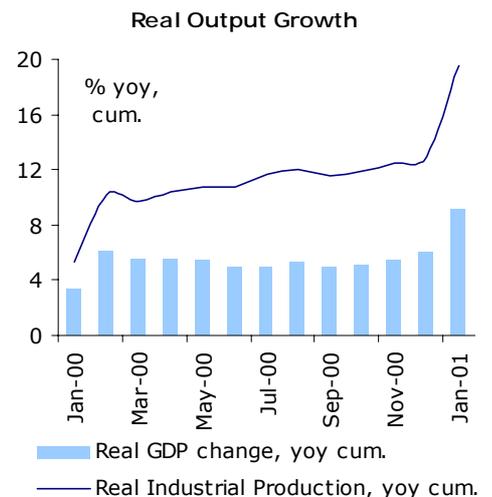
Politics: Supporting growth in 2001?

Co-operation between the IMF and Ukraine under the EFF programme, which had been resumed two months ago after a yearlong pause, might again come to a standstill. The IMF is not likely to release the next EFF credit tranche to Ukraine in March. The prime preconditions for the IMF are raising the level of cash payments for electricity and reducing the sunflower seed export duty.

On 19 January, President Kuchma dismissed Yulia Tymoshenko, the Deputy Prime Minister in charge of the fuel and energy sectors, and in fact eliminated this post. Instead, President Kuchma appointed Oleg Dubyna as the Deputy Prime Minister for Industrial Reforms, previously manager of the Kryvorizhstal steel mill. The fate of Yulia Tymoshenko's programme for reform of the coal sector, previously approved by the Government and aiming at eliminating shadow mechanisms, remains unclear.

Real economy: High time for structural reforms

The remarkable GDP growth rate of 9.1% in January seems to be a logical continuation of the Ukrainian economic upturn in 2000. Industrial production in January grew strongly at 19.5% yoy and agriculture at 0.5% yoy. As in 2000, the light, food- and wood-processing industries showed the best results. Metallurgy continued to grow (by 27.4% yoy) despite worsening external conditions. Machine building also kept on expanding (24.4% yoy growth). This favourable economic situation is also reflected on the expenditure side. Fixed capital investments rose by 11.2% yoy to UAH 19.48 bn in 2000, clearly testifying to positive business expectations in the economy. Yet, retained earnings remained the main source for capital investment financing in 2000 comprising 67.7% of total capital investments. Foreign investments accounted for 4.1% only, a worrying indication of the low level of confidence in Ukrainian economic prospects by foreigners.



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The current economic situation is very favourable for measures to develop a strong and competitive economy. In order to sustain the present growth momentum, structural reforms should become a priority now.

Sectoral trends: New growth dynamics

Energy. The Cabinet has postponed the privatisation tenders for energy distribution companies (Oblenergos), scheduled for February 22 and March 1, by two months at the request of investors and CSFB, the advisor for the Oblenergos' privatisation. The Government has already passed a resolution on restructuring of the debt of the Oblenergos and has significantly cut the list of enterprises that cannot be disconnected from power. But a new tariff policy has not been approved yet. Overall in 2000, the Government achieved a certain success in reforming the energy sector by raising the levels of cash payments on the wholesale electricity market and on the market for natural gas.

Privatisation. In accordance with its privatisation plan, Ukrtelecom has increased its stake in its subsidiary UTEL to almost 80%, by buying back shares from foreign owners (AT&T and Deutsche Telekom). It intends to buy back the rest of the foreign held shares at the beginning of the second quarter of 2001. However, Ukrtelecom's privatisation is not likely to be completed by the end of this year, unless the work of the Privatisation Commission on Ukrtelecom is actively promoted.

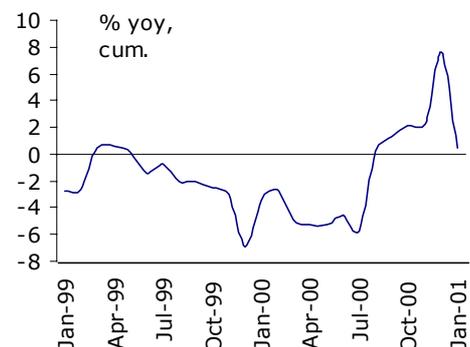
Agriculture. A number of important laws for the further development of Ukraine's agricultural sector were passed in January. As a continuation of reforms in the agricultural sector, they assure a further sharing of assets of former collective farms. However, they also foresee the introduction of a pledge price system for agricultural commodities, define mechanisms for interest rate compensation on agricultural commercial credits by the state. Besides, the Government reduced the debt of agricultural enterprises on government loans and rescheduled the remaining debt. But since many farms are still not creditworthy and basic conditions for lending to farms have not been met (neither a new bankruptcy procedure nor the new Land Code exists in Ukraine as yet) many farms will remain without external financing this year. Moreover, pledge prices for agricultural commodities are unlikely to function due to the absence of adequate state funds.

External sector: Danger ahead?

In 2000 Ukraine achieved a remarkable foreign trade expansion. Merchandise exports grew by 25.8% and imports by 17.8%, boosting the merchandise trade surplus to USD 616.5 m. In 1999 merchandise trade had a USD 264.5 m deficit. Due to weak demand and low prices on the international commodity markets caused by a global growth slowdown, Ukrainian exporters might face some problems during the first half of 2001. This particularly concerns the metallurgical sector, which accounts for 44% of Ukrainian merchandise export earnings. Ukrainian producers were also hampered by a real appreciation of the Hryvnia, their costs of production rising faster than those of their competitors. Despite all these worrying tendencies, the Ukrainian Government remains quite optimistic and hopes for growth rates of 4.2% for exports and of 3.9% for imports in 2001, and also for maintaining a significant current account surplus, same as in 2000.

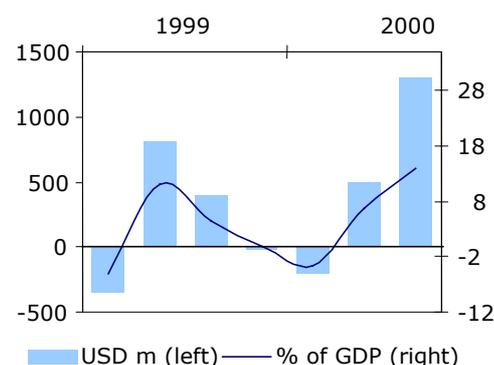
The net FDI inflow into Ukraine's economy grew from USD 437 m in 1999 to USD 583 m in 2000. However, it did not reach the level of 1998, which might be an indication of the misgivings foreign investors have about the sustainability of strong growth in Ukraine.

Agricultural Production



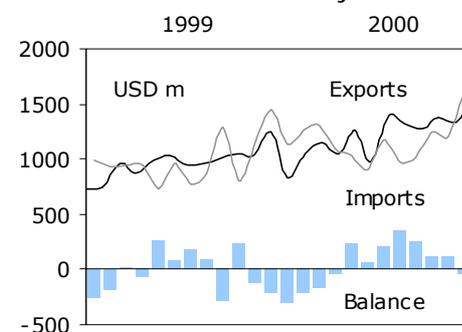
Source: Derzhkomstat

Current Account Balance



Source: NBU

Merchandise Trade Dynamics



Source: Derzhkomstat



Fiscal policy: Internal debt market to be revived

On January 31, 2001, the Government approved a decree specifying the rules for its domestic borrowings this and in coming years, and aimed at reviving the domestic debt market. Two types of instruments will be issued: short-term Government discount bills with maturities up to 1 year and medium-term Government coupon bonds with maturities from 1 to 5 years. While discount bills are similar to OVDPs, coupon bonds are new to the domestic market. This year the Government plans to borrow UAH 2.1 bn at the internal market, but will have to pay UAH 2.03 bn in interest, and UAH 1.7 bn in principal repayments. To better control the debt situation, a special fund for the management of the state debt is now being organised.

The good revenue collection continued in January, growing by 33% yoy. This was mainly due to a strong growth of tax revenues, but non-tax revenues could become a major threat to revenue totals this year. Actual privatisation receipts in January were about half of what had been projected.

Monetary policy: First sterilisation success

In January 2001 the CPI inflation rate was high at 1.5% mom (or 22.1% yoy), mainly due to rises in food prices. The Government's inflation forecast of 13.6% seems to be a rather ambitious target. The National Bank of Ukraine, being criticised for pursuing an inflationary monetary policy in 2000, intends to reduce the rate of money supply growth, implementing an anti-inflation plan. Faced with an increase of about 45% in M3 and a 40% rise of the monetary base (MB) in 2000, the NBU withdrew surplus Hryvnias in January by selling its own certificates of deposit and government securities to commercial banks on conditions of their repurchase ("reverse REPOs"). It is evident that a change in monetary policy has taken place: with these instruments the National Bank sterilised UAH 948 m in January - more than the total amount of money withdrawn in 2000 (UAH 922 m). In January the NBU failed to sell interest-bearing government bonds (POVDPs) with a nominal value of UAH 9.56 bn from its portfolio due to an absence of demand. The NBU will attempt to promote the POVDP market to attract surplus liquidity from commercial banks and seek other instruments to manage the money market.

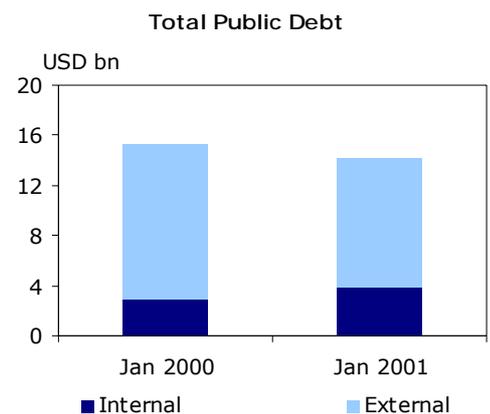
The inflation rate in the first quarter may remain high because of these problems with sterilisation, and because of seasonal factors and price inertia.

Financial markets: Hryvnia will remain stable for now

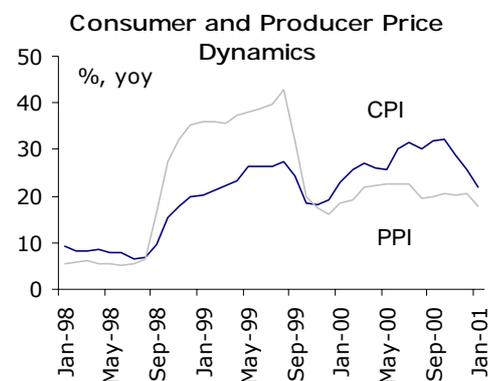
Foreign currency market. The Hryvnia exchange rate remained stable in January. According to NBU officials, there will be no policy changes in the inter-bank currency market. The NBU will continue to buy out large volumes of foreign currency; also, no currency trading liberalization is planned.

Stock market. The January volume of trades at the PFTS (the largest Ukrainian stock market) was UAH 120 m. This is 48% lower than the record high level of December, but is about equal to the average monthly trade in 2000. The PFTS index rose by 1.67% from 55.53 to 56.46.

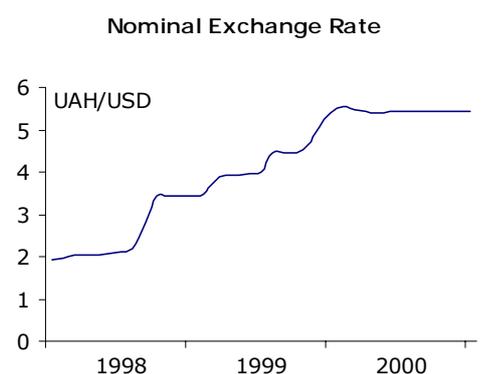
Banking sector. Commercial banks ended year 2000 with UAH 29.5 m in combined losses, the worst result since independence. Despite the majority of banks, 142 out of 154, made profits at the level of UAH 478.5 m, 12 loss-making banks were enough to tip the scale of overall performance. The biggest loss-makers were Slavianskiy bank (UAH 325 m losses) and Ukraina bank (UAH 96 m losses).



Source: Ministry of Finance



Source: Derzhkomstat



Source: NBU

**Economic Trends**

		Q1 00	Q2 00	Q3 00	Q4 00	Nov	Dec	Jan
GDP growth (real)	% yoy	5.5	4.5	5.1	...	8.0	...	9.1
GDP growth (real)	% yoy cum.	5.5	5.0	5.0	6.0	5.4	6.0	9.1
Industrial production (real)	% yoy	6.7	7.5	13.0	...	12.6	16.5	19.5
Agricultural production (real)	% yoy cum.	-4.9	-4.9	1.3	9.2	2.2	7.6	0.5
CPI	% yoy	0.0	0.0	0.0	28.9	28.9	25.8	22.1
PPI	% yoy	0.0	0.0	0.0	20.4	20.1	20.8	17.8
Exports (gs, USD)	% yoy cum.	24.8	16.4	20.1	...	25.9*	25.8*	...
Imports (gs, USD)	% yoy cum.	19.4	19.8	16.0	...	19.3*	17.8*	...
Merchandise trade balance	USD bn	-0.43	0.24	0.29	0.22	0.07	-0.01	...
Current account	USD bn eop	-0.21	0.49	1.30
Current account	% GDP	-3.5	6.8	13.9
Official reserves	USD bn eop	0.94	0.81	0.83	1.63	1.22	1.63	1.72
Monetary Base	% yoy eop	47.9	35.7	34.5	39.9	34.2	39.9	...
Lending rate (in UAH)**	% pa, eop	35.7	31.7	32.5	31.2	32.0	31.2	...
Exchange rate	USD aop	5.47	5.44	5.44	5.44	5.44	5.44	5.43
Exchange rate	EUR aop	5.28	5.15	4.76	4.72	4.65	4.88	5.10

SOURCE: Derzhkomstat, Ministry of Finance, NBU, Deutsche Bank Research, European Central Bank, own calculations

*Monthly figures that are only for merchandise exports and imports (source: Derzhkomstat)

** Weighted average for different maturities (source: NBU)

Key Economic Indicators

		1995	1996	1997	1998	1999	2000
Nominal GDP	USD bn	37.0	44.6	50.2	41.9	30.8	32.2
GDP growth (real)	% yoy	-12.2	-10.0	-3.0	-1.9	-0.4	6.0
Industrial production	% yoy	-24.5	-0.6	-1.2	-1.7	2.2	12.9
Agricultural production	% yoy	-4.6	-9.5	-1.9	-9.8	-6.9	7.6
Private consumption	% yoy	-1.6	-9.2	0.5	2.0	1.5	6.9 *
CPI	% yoy aop	28.2	23.6	15.9	10.6	22.7	28.2
CPI	% yoy eop	181.4	39.7	10.1	20.0	19.2	25.8
PPI	% yoy aop	488.9	52.1	7.7	13.2	31.5	20.9
Exports (gs, USD)	% yoy	-0.9	23.4	0.0	-13.4	-7.9	19.0 *
Imports (gs, USD)	% yoy	-4.0	24.2	2.0	-14.0	-19.1	16.0 *
Terms of trade	% yoy	-6.5	2.6	6.3	1.5	-10.6	2.2 *
Current account	USD bn	-1.2	-1.2	-1.3	-1.3	0.8	2.25 *
Current account	% GDP	-3.1	-2.7	-2.7	-3.1	2.7	7.0 *
FDI (net)	USD bn	0.3	0.5	0.6	0.7	0.5	0.6
Gross official reserves, net gold	USD bn	0.9	1.9	2.3	0.6	1.0	1.6
Fiscal balance	% GDP	-7.3	-4.5	-6.6	-1.9	-1.3	0.7
Total public debt	% GDP	41.7	25.0	30.4	51.5	62.8	44.1
External debt (total)	% GDP	27.0	20.5	19.4	38.4	51.0	32.2
Monetary base	% yoy eop	132.3	38.0	44.6	21.9	39.3	39.9
Exchange rate	USD aop	1.5	1.8	1.9	2.4	4.1	5.4
Exchange rate	USD eop	1.8	1.9	1.9	3.4	5.1	5.4
Exchange rate	EUR aop	1.9	2.3	2.1	2.8	4.4	5.0
Exchange rate	EUR eop	2.3	2.4	2.1	4.0	5.1	4.8
Real exchange rate (CPI defl.)	% yoy eop	32.5	31.0	9.8	-14.5	-20.1	14.4

SOURCE: Derzhkomstat, NBU, Deutsche Bank Research, European Central Bank, own calculations

NOTE: Fiscal balance is calculated by State treasury methodology (privatisation revenues included; Pension Fund excluded)

* forecast

Notes:

aop	average of the period	eop	end of the period
avg	average	gs	goods and services
bp	basis points	mom	month over month change
cum.	cumulative	yoy	year over year change