

Monthly Economic Monitor Ukraine

- At the end of April the reformist government of Viktor Yuschenko was dismissed after a year-long service.
- High GDP growth of 7.7% yoy cum. for the first quarter is likely to continue. Qualitative changes in the growth structure are evident.
- Six regional power distribution companies (oblenergos) were privatised in April 2001. The state received around USD 150 m out of planned USD 250 m.
- January-February trade performance is a source of optimism, while new restrictions on metallurgy exports raise serious concerns about the persistence of this trend.
- Increased budget receipts from the tax and customs authorities made up for the fall in privatisation receipts in the first quarter. But April's revenue target will not be met.
- Further decrease of the NBU rates and part of the reserve requirements signal desire to ease monetary policy

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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: Yuschenko's Cabinet dismissed despite wide public support of its current course

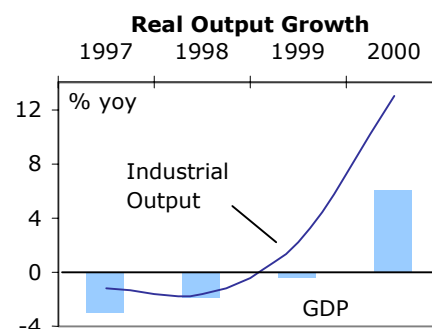
An almost month-long political debate about the performance of Viktor Yuschenko's Cabinet during its first year of activity has resulted in his dismissal by Parliament at the end of April. Communists allied with some factions representing powerful business groups judged the work of the Government to be unsatisfactory and later voted no confidence to it by 263 out of 409 votes. Yuschenko's Cabinet was a successful government that gained wide support in the international arena and trust within society. Its main achievements during yearlong activity include acceleration of sluggish economic reforms, especially in the energy sector and agriculture, paying back huge wage and pension arrears and securing the first positive economic growth since Ukraine gained independence in 1991. The dismissal of Viktor Yuschenko's Cabinet can be considered as a sign of lack of political consensus within society and among political forces regarding Ukraine's transition course.

The monitoring committee of the Parliamentary Assembly of the Council of Europe (PACE) claimed that Ukrainian authorities frequently violate freedom of speech and press principles. Ukraine's exclusion will be examined if 'considerable progress' is not achieved in the compliance with PACE principles till its June session. This decision will mean additional pressure for adaptation of important laws and for restricting the state's abuse of power towards political opposition. Ukraine has recently ratified a new Criminal code and the law on political parties; ratification of the Civil code is expected.

President Leonid Kuchma is initiating the creation of a special organ promoting Ukraine's accession process to EU membership. The EU is currently concerned about freedom of speech and state of democracy in Ukraine. Approval of the Law 'On the Customs Tariffs of Ukraine' in accordance with GATT/WTO system was an important step towards further trade liberalisation. With exception of some products, import duty rates on 97 commodity groups were unified and significantly reduced to at most 20% on average. Cabinet is left with the right to regulate import duty rates.

Real economy: High growth figures backed by qualitative improvements in production structure

GDP posted a significant growth of 7.7% yoy cum. in January-March 2001 without the seasonal decline. Growth of industrial



Source: Derzhkomstat

Institute of Economic Research
 and Policy Consulting
 Khreshchatyk 30/1, 01001 Kyiv,
 Tel. (+38044) 228-6342,
 Fax (+38044) 228-6336
 E-mail: institute@ier.kiev.ua
<http://www.ier.kiev.ua>

production in the first quarter totalled 17.4% yoy cum. (18.1% yoy in March), with barter transactions falling. Persistent high growth in processing industries (23.7% yoy cum.), domestic trade (9.0%) and construction (8.6%) is the evidence of qualitative changes in growth structure, rise of domestic demand role, and revival of investment activity. Structural reforms in agriculture pushed in 2000 have become the prerequisites for the growth of production in this sector (by 6.1% yoy cum. in first quarter). It is possible to forecast that such good growth performance will continue in the nearest future; the industrial production may grow by 17.6% and GDP by 7.5% yoy in April. Overall for the year 2001 the GDP growth may well exceed the forecasted 4%. The political crisis connected with Viktor Yushenko's dismissal will probably have negative consequences on foreign investments inflow, but lesser impact on domestic production. However, in the medium term the continuation of bold structural reforms is of paramount importance due to the still existing structural fragility of the Ukrainian economy.

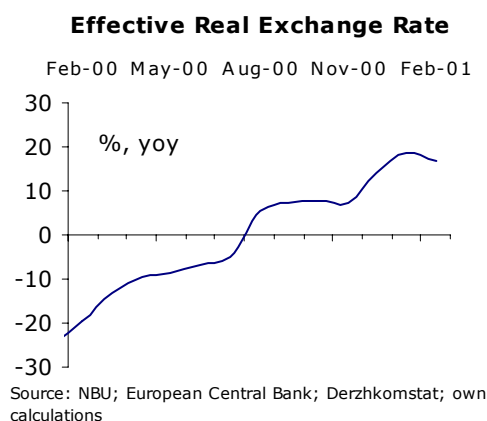
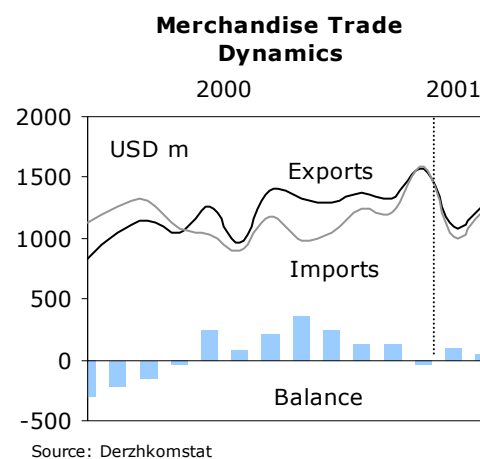
Sectoral trends: Six oblenergos sold for USD 150 m

Privatisation. Six Ukrainian regional power distribution companies (oblenergos) were privatised in April 2001. American AES Washington Holdings won the tender for Kiev- and Rivneoblenergo. Slovakian Vychodoslovenske Energeticke Zavody won in the tender for Zhytomyr-, Kherson-, Kirovogradoblenergo, and Sevastopolenergo. Total revenue produced by the sale amounted to around USD 150 m with a planned revenue of USD 250 m. Political risk might have driven down the market value of the oblenergos.

Agriculture. In 2001 the government continues to support agriculture. In early 2001 it drafted a program aimed at stabilizing the livestock industry, which awards UAH 125 m in budget subsidies to livestock farms. While its impact will be evident in the long run, the growth observed in agriculture is attributed exactly to a better productivity in livestock production. Another government subsidy in the amount of the UAH 150 m for the interest rate compensation on commercial credits has already been used by agricultural producers and has provided for around UAH 1.1 bn in credits.

External Sector: Metallurgy export restrictions may lead to deterioration of trade balance

A stable Hryvnia and a low inflation rate in the first quarter determined a slow down of the real exchange rate appreciation trend. Goods exports continue to grow for the second month (up 21.7% yoy cum.), while imports are falling by 9.6% yoy. Ukraine's merchandise trade amounted to USD 4.6 bn, the trade surplus increased to USD 140.4 m in January-February. While the first quarter trade performance may be the source of optimism, there are serious concerns about the persistence of this trend. In particular, Ukrainian metallurgy producers, who account for around 30% of country's exports, became subject to considerable restrictions on the major markets. As the result of the negotiation between Russian and Ukrainian Prime Ministers, an import quota for Ukrainian pipes at 620 thousand tones was established by Russia, 20% less than actual volumes of 2000. Additional threats come from the USA market where a provisional antidumping duty of 89.49% for hot-rolled steel was set. It appears that the United States is standing by its promise to close its market to ferrous metals. Fortunately, the EU has decided to prolong the agreement on steel exports, which will expire this year for another three years and raise the quotas slightly. This will protect Ukraine against antidumping investigations in this region. The possible reduction of metallurgy exports in 2001 increases the probability of a deterioration of the trade balance this year.



Fiscal policy: How serious is the present fall in the Central budget revenues?

The first quarter of 2001 has shown a high rate of tax and non-tax revenue collections, both to the Central and to local budgets, resulting in 14.0% yoy real growth in the Consolidated budget revenues. Increased receipts from tax and customs authorities made up for the fall in privatisation receipts (60% of the quarterly projections). However, Central budget revenues faced a decrease in April and the month's revenue target will not be met. Among the possible reasons are write-off or restructuring of significant amount of tax debts and depriving the tax office of the right to unilaterally withdraw funds from the banking accounts of tax debtors in accordance to the recently enacted law (abolishment of Kartoteka 2). The latter part of the law can positively influence the budget revenues if it is followed by an increase in the official activity of enterprises. Provided that economic growth continues, the effects of this law and complications in the privatisation process can be among the major risks for achieving yearly revenue targets. Broadening the tax base by giving up tax privileges could compensate for the reduction in budget revenues.

Monetary policy: Signals about easing

After relatively stable prices in the first quarter (2.7% cum. since the start of the year) April CPI inflation rose to 1.5% mom (17.0% yoy) mainly due to increase in food prices. There is still little ground for downgrading the official inflation forecast from 13.6% to 10.0% yoy in the end of 2001 as was disclosed by the Ministry of Economy.

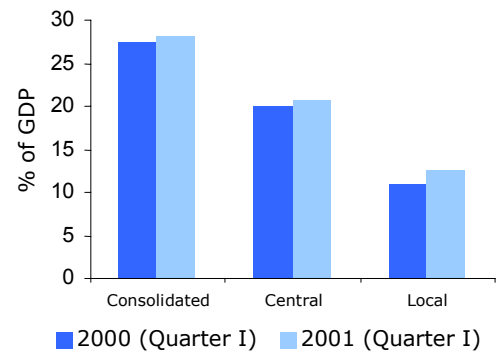
According to NBU officials, monetary policy in 2001 will be concentrated on open market operations, development of state debt market and introduction of new financial instruments, individual deposit insurance and promotion of banks' investment activities. In line with these aims the NBU cut the discount rate from 25% to 21% and started refinancing commercial banks through permanent overnight credit line since early April. The interest rate is based on the Lombard rate and will be released daily. In April the NBU provided to commercial banks UAH 346 m at the rate 22-27% p.a. Further decreasing of NBU's rates is possible. Reserve requirements on long-term deposits with commercial banks were also reduced. These two measures are possibly not very effective, but they signal the NBU's desire to ease its monetary policy and to promote the banks' crediting of domestic production.

Financial markets: PFTS index fell 6% after Yuschenko's dismissal

Foreign exchange market. The National Bank of Ukraine intends to continue its policy of upholding the value of the hryvnia, preventing it from rising or falling. The NBU Head Volodymyr Stelmakh does not support the frequently expressed view about the necessity of Hryvnia devaluation in order to boost exports.

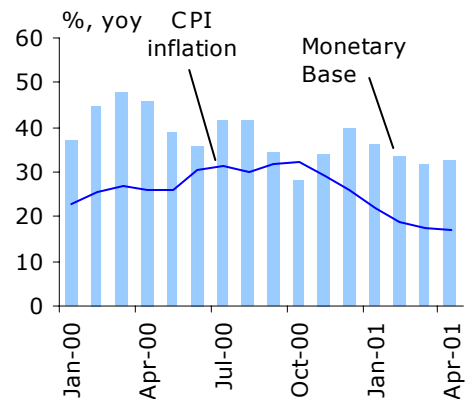
Stock market. Reacting to the dismissal of Prime Minister V. Yuschenko, the PFTS index dropped by 6%, the sharpest decline since the financial crisis in 1998. It is expected that the Ukrainian stock market will loose some liquidity and will be lacking interest from foreign investors in the middle run, but over longer period will hopefully get stable.

Budget Revenue Dynamics



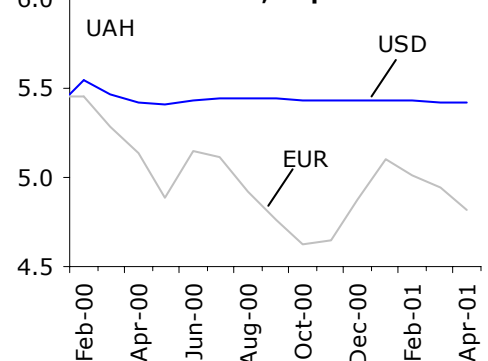
Source: State Treasury

Monetary Base and Price Developments



Source: Derzhkomstat; NBU

Nominal Hryvnia Exchange Rate, aop



Source: NBU


Economic Trends

		Q1 00	Q2 00	Q3 00	Q4 00	Q1 01	Jan	Feb	Mar	Apr
GDP growth (real)	% yoy	5.5	4.5	5.1	6.7*	7.7	9.1	6.2	7.8	7.5 *
GDP growth (real)	% yoy cum.	5.6	5.0	5.0	6.0	7.7	9.1	7.6	7.7	7.6 *
Industrial production (real)	% yoy	6.7	7.5	13.0	...	17.4	19.5	12.6	18.1	17.6 *
Agricultural production (real)	% yoy cum.	-4.9	-4.9	1.3	9.2	6.1	...	...	...	...
CPI	% yoy	25.1	27.4	31.1	28.9	19.4	22.1	18.9	17.3	17.0
PPI	% yoy	19.9	22.5	20.6	20.4	15.6	17.8	16.4	12.8	10.8
Exports (gs, USD)	% yoy cum.	24.8	16.4	20.1	19.6	...	32.1"	21.7"	...	...
Imports (gs, USD)	% yoy cum.	19.4	19.8	16.0	15.0	...	-10.9"	-9.6"	...	...
Merchandise trade balance	USD bn	-0.43	0.24	0.29	0.22	...	0.09	0.05	...	...
Current account	USD bn eop	-0.21	0.49	1.30	0.3	...	...	...	...	...
Current account	% GDP	-3.5	6.8	13.9	3.0	...	...	...	...	...
Official reserves	USD bn eop	0.94	0.81	0.83	1.63	...	1.72	1.78	...	...
Monetary Base	% yoy eop	47.9	35.7	34.5	39.9	32.0	36.1	33.6	32.0	32.6
Lending rate (in UAH)**	% pa, eop	35.7	31.7	32.5	31.2	...	31.3	30.7	...	...
Exchange rate	USD aop	5.47	5.44	5.44	5.44	5.43	5.43	5.43	5.42	5.42
Exchange rate	EUR aop	5.28	5.15	4.76	4.72	5.01	5.10	5.01	4.94	4.82

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

" Monthly figures applying only to merchandise exports and imports (source: Derzhkomstat)

* Forecast

** 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	5.0 *
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	19.6 †
Imports (gs, USD)	% yoy	-4.0	24.2	2.0	-14.0	-19.1	15.0 †
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	1.9
Current account	% GDP	-3.1	-2.7	-2.7	-3.1	2.7	5.8
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 eop	41.7	25.0	30.4	51.5	62.8	44.1
External debt (total)	% GDP eop	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	4.9
Real exchange rate (CPI defl.)	% yoy eop	32.5	31.0	9.8	-14.5	-20.1	14.3

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