

Monthly Economic Monitor Ukraine

- Parliament approved Anatoliy Kinakh as the new Prime Minister of Ukraine.
- The GDP grew by 8.5% yoy cum. during January-April with record results in industrial production. The first half-year growth prospects are quite promising.
- The first quarter trade surplus came to USD 816 m. Pressure on the Ukrainian exporters on the major markets is increasing.
- Government expenditure reductions for fiscal 2001 are very likely, due to the continuing shortfall in revenues.
- The inflation in May declined to 15.1% yoy but difficulties with stimulating the domestic debt market raise concerns about effective control over money supply in the future.
- The first quarter of 2001 appears to have been successful for the banking sector with UAH 155 m of profits. Reforms at the Bank "Ukraina" have begun.

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June
2001**

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: Ukraine's new Prime Minister was appointed

After a month-long debate Anatoliy Kinakh, the head of the Ukrainian Union of Industrialists and Entrepreneurs, was approved by Parliament to be the new Prime Minister. Among his main priorities he listed the continuation of tax and administrative reforms, further reforms in the agricultural and energy sectors, 'innovative' (instead of 'fiscal') approaches to the privatisation process, support of domestic producers, and reduction of poverty. Oleg Dubyna was appointed to the position of first Vice Prime Minister, while majority of ministers from the Yuschenko Cabinet retain positions in the new government. They are, among others, the Minister of Finance Igor Mityukov and the Minister of Economy Vasyly Rogovyi.

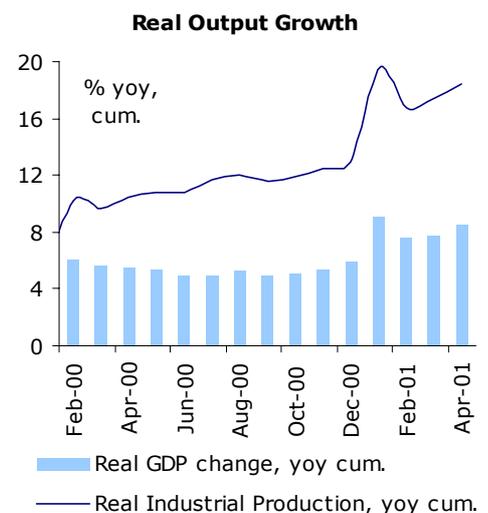
New positions of state secretaries at the Cabinet level and for all ministries were introduced as a further step in administrative reform. They will be appointed for the five-year presidential term, during which time they cannot be removed even in the case of a change of Government. Their functions and the extent of their authority over policy are still unclear. While this step is aimed at enhancing the stability of economic policy, a power centralisation such as this raises serious concerns.

Parliament rejected the draft of the Land Code during second reading due to differing opinions about trading agricultural land. This delay with the new code is claimed to be one of the impediments to increasing investment and to developing sustainable credit mechanisms in Ukraine's agricultural sector.

The Budget Code, adopted by Parliament in March, was not so far sent to the President due to some controversies with the text. This delay retards the preparations of the Budget for 2002.

Real economy: High growth is expected in the first half year

In April the GDP grew by an impressive 10.8% yoy (8.5% yoy cum. since the start of 2001) primarily due to high growth in industry (18.4%). However, industrial output declined in April by 1.6% as compared to March and a high proportion of enterprises decreased their production. Despite this sign of cooling, it looks like the positive momentum of the first quarter will continue in the coming months and the first half of the year. However, growth in almost all sectors - with the exception of agriculture, maybe - is secured only by internal resources of the enterprises. A change in government leads to uncertainty about future industrial policy and a reduced willingness of commercial banks to provide credits to the industrial



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sector. Without diversified investment sources the growth rate of all industries may continue to decrease.

Sectoral trends: First signs of reforms in agriculture

Agriculture. The reforms in the agricultural sector show first results. Farmers have finished spring planting in time. The new credit mechanism for agricultural enterprises based on a partial interest rate compensation by the state has helped to bring this achievement about (UAH 1.5 bn of credits were provided). Better preparation for the sowing campaign and favourable weather conditions raise the hopes for a better harvest this year. That may turn Ukraine from a net importer to a net exporter of some crops, and eventually drive domestic prices down.

Energy. A recent agreement between the presidents of Ukraine and Turkmenistan envisages the delivery of 250 bn cubic meters of natural gas to Ukraine at a price of USD 42 per thousand cubic meters during 2002 to 2006. Half of the natural gas deliveries are intended to be paid for in cash, the other by various services. Thus, a further step to the diversification of energy sources for Ukraine was made.

In March-April 2001 the level of cash payments by the oblenegos to the wholesale electricity market stabilized at a level of about 70%. One hundred percent cash payment is not feasible as long as debtors cannot be disconnected from the power supply.

Infrastructure. A container and automobile transportation terminal has been opened at the Illichevsk merchant seaport. Regular ferry services between Illichevsk and Poty/Batumi have been established as a part of the Euro-Asian transport corridor. The terminal is capable of handling 22,600 European-standard containers and 1,500 automobiles per year.

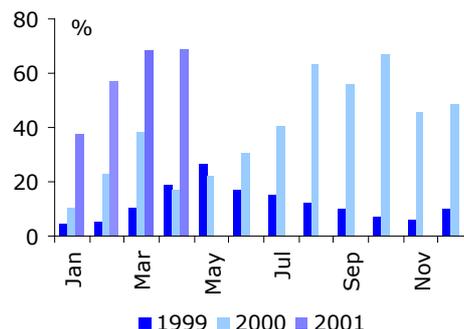
External Sector: External markets conditions continue worsening

In the first quarter of 2001 the foreign trade surplus came to USD 816 m, as opposed to the USD 37 m deficit for the same period last year. With that, exports grew by 16% yoy, while imports declined by more than 5.0% yoy. Merchandise trade experienced a surplus of USD 239.2 m and the trade in services surplus reached USD 576.9 m. While Ukraine enjoyed positive trade dynamics in the first quarter, the situation at foreign markets stayed unfavorable. In addition to previous anti-dumping investigations, the United States claimed dumping by Ukrainian steel armature producers and Russia initiated an anti-dumping process concerning salt imports from Ukraine. Moreover, Russia is increasing its export duty on gas from 5% to 10% and pushing Poland to accept the plan of building a gas pipeline bypassing Ukraine.

Fiscal policy: Is a reduction in Central budget expenditures likely this year?

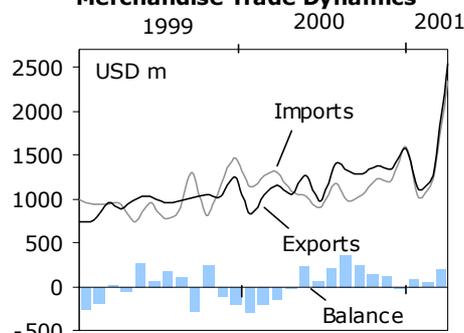
Central budget revenues fell in April and preliminary data indicate the same to be true for May. Lower gas exports from Russia during January to April 2001, led to a loss in transit revenues of UAH 600 m. The temporary suspension of privatisation in the energy sector will also threaten budget revenues. Thus, government expenditures will very likely have to be cut this year. Under present circumstances, the development of the internal debt market is very important. However, market participants show little interest in government securities. Since the beginning of the year, only UAH 398 m were sold. This month the Ministry of Finance started to service KGOs (short-term government bills) issued in February (UAH 32.4 m).

Cash Payments by Oblenegers as % of Electricity Supply



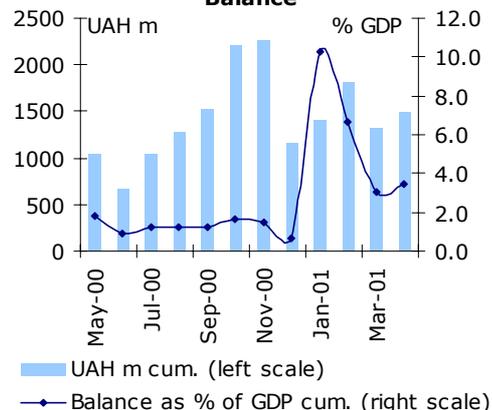
Source: NERC

Merchandise Trade Dynamics



Source: Derzhkomstat

Consolidated Budget Balance



Source: State Treasury (Privatization receipts included; Pension Fund excluded)

Monetary policy: Inflation is low but problems with sterilisation still exist

According to preliminary estimates by the National Bank of Ukraine (NBU) the monetary base grew by 4.9% cum. (29.7% yoy) and the broad aggregate M3 by 9.7% cum. (35.2% yoy) since the beginning of the year by June 01. The inflation in May was 0.4% mom (15.1% yoy) and totaled 4.7% cum. since the start of 2001. While the currency in circulation decreased by 1.5% mom in May, the problem with the future sterilization of the money supply still exists. Interest by commercial banks in interest-bearing government bonds (POVDPs) held by the NBU is very weak in spite of an increase this month as compared to April. Between the beginning of the year and end May the NBU sterilized about UAH 1.8 bn, while only 8% of this was due to sales of POVDPs. The NBU's certificates of deposit and 'reverse REPO' remain the major tools of monetary control. Despite timely coupon payments on POVDPs in 2001 by the Ministry of Finance, commercial banks remain very skeptical about these papers. It looks as if the NBU has difficulties to revive the domestic debt market.

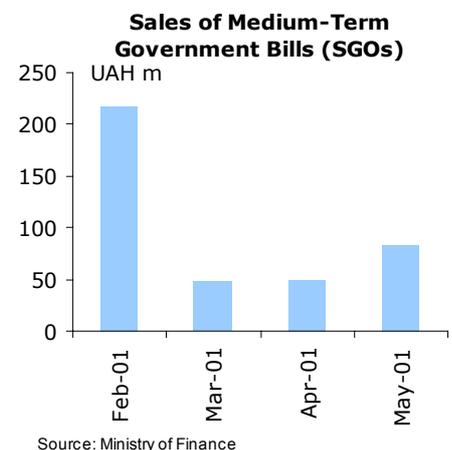
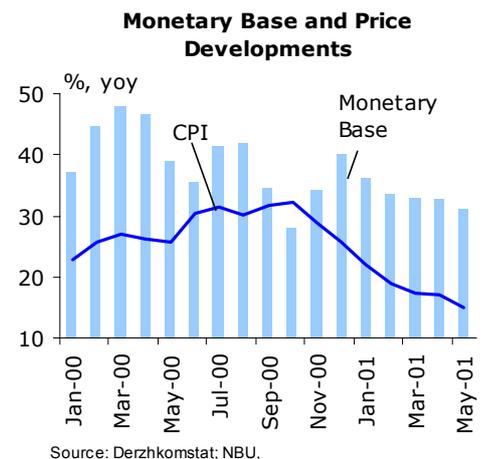
Financial markets: Ministry of Finance and the NBU to hold weekly consultations on debt market situation

Government debt market. The NBU and the Ministry of Finance agreed to hold weekly consultations to coordinate their activity in the domestic debt market. This measure is an attempt to resolve the conflict between the open market sales of POVDPs by the NBU and the Ministry's primary placements of new domestic bonds.

Banking sector. The first quarter of 2001 was relatively successful for the Ukrainian banking sector. The financial result of the commercial banks reporting to the Association of Ukrainian Banks came to UAH 155 m, while the ROA (return on assets) stood at 0.5%. Last year the banking sector suffered losses of UAH 30 m. Although bank credits in the first quarter increased by UAH 2.4 bn, nearly 40% of this amount comprised subsidized credits to the agricultural sector. Recently the growth of credit slowed down as the state subsidy quota for 2001 was exhausted.

The financial sanation of the Bank "Ukraine" seems to move ahead now with the agreement between the Ukrainian government and the World Bank on transferring "Ukraine" deposits to another bank. Reform of the Bank "Ukraine" is one of the major stumbling blocks for getting the credits from international financial organisations.

Foreign exchange market. By the end of April 2001 the NBU had accumulated more than USD 1.8 bn of foreign reserves, a record high level for the last years. A continuing flow of foreign currency proceeds from exports created a favourable situation in the foreign exchange market and allowed the NBU to preserve the stability of the Hryvna this year. Government officials forecast a stable Hryvna for an even longer period, using an exchange rate of UAH 5.75 per USD in the planning for fiscal 2002.





| Economic Trends | | Q1 00 | Q2 00 | Q3 00 | Q4 00 | Q1 01 | Jan | Feb | Mar | Apr | May |
|--------------------------------|------------|--------------|--------------|--------------|--------------|--------------|------------|------------|------------|------------|------------|
| GDP growth (real) | % yoy | 5.5 | 4.5 | 5.1 | 8.9 | 7.7 | 9.1 | 6.2 | 7.8 | 10.8 | ... |
| GDP growth (real) | % yoy cum. | 5.5 | 5.0 | 5.0 | 6.0 | 7.7 | 9.1 | 7.6 | 7.7 | 8.5 | ... |
| Industrial production (real) | % yoy | 6.7 | 7.5 | 13.0 | ... | 17.4 | 19.5 | 12.6 | 18.1 | 18.4 | ... |
| Agricultural production (real) | % yoy cum. | -4.9 | -4.9 | 1.3 | 9.2 | 5.1 | ... | ... | ... | ... | ... |
| CPI | % yoy eop | 26.9 | 30.3 | 31.7 | 25.8 | 17.3 | 22.1 | 18.9 | 17.3 | 17.0 | 15.1 |
| PPI | % yoy eop | 22.0 | 22.6 | 19.9 | 20.8 | 12.8 | 17.8 | 16.4 | 12.8 | 10.8 | 10.1 |
| Exports (gs, USD) | % yoy cum. | 24.8 | 16.4 | 20.1 | ... | 15.8 | 32.1" | 21.7" | 20.9" | ... | ... |
| Imports (gs, USD) | % yoy cum. | 19.4 | 19.8 | 16.0 | ... | -5.4 | -10.9" | -9.6" | -5.8" | ... | ... |
| Merchandise trade balance | USD bn | -0.43 | 0.24 | 0.29 | 0.22 | 0.24 | 0.09 | 0.05 | 0.10 | ... | ... |
| 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 | ... | 1.81 | ... |
| Monetary Base | % yoy eop | 47.9 | 35.7 | 34.5 | 39.9 | 32.0 | 36.1 | 33.6 | 33.1 | 32.6 | 29.7 |
| Lending rate (in UAH)** | % pa, eop | 35.7 | 31.7 | 32.5 | 31.2 | 30.3 | 31.3 | 30.7 | 28.8 | ... | ... |
| Exchange rate | USD aop | 5.47 | 5.44 | 5.44 | 5.44 | 5.43 | 5.43 | 5.43 | 5.42 | 5.42 | 5.41 |
| Exchange rate | EUR aop | 5.28 | 5.15 | 4.76 | 4.72 | 5.01 | 5.10 | 5.01 | 4.94 | 4.82 | 4.76 |

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 | 9.2 |
| 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 | 20.8 |
| 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

† Preliminary NBU estimates

Notes:

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