



# Monthly Economic Monitor Ukraine

- In July, real GDP growth reached its highest level – 10.5% yoy cum. – since the beginning of the economic recovery in Ukraine. This is mainly due to a boost in value added in agriculture.
- From January to July 2001, state budget revenues from privatisation reached only 58% of the targeted level for this period.
- Due to higher than foreseen tax and non-tax revenues, the consolidated budget was in surplus.
- Despite economic growth, the net FDI inflow in the first half of the year was 20% lower than during the same period in 2000.
- Decreases in the spread between the average credit and deposit rates of commercial banks may indicate a growing efficiency of financial intermediation.
- The decline in the risk premium of Ukrainian Eurobonds signifies a reduction in the perceived default risk on the sovereign debt of Ukraine.

**No.9 (11)  
September  
2001**

Population: 49.4 m  
Industry/GDP: 28.6%  
Agriculture/GDP: 11.7%  
Investment/GDP: 18.6%  
Export destination: Russia 24%, EU 16%  
Import origin: Russia 42%, EU 21%

## Politics: Ukraine celebrated the 10<sup>th</sup> anniversary of its independence

On August 24, Ukraine celebrated the 10<sup>th</sup> anniversary of its independence. The establishment of an independent governmental structure, the introduction of a national currency, as well as resumed economic growth top the list of major achievements of the state.

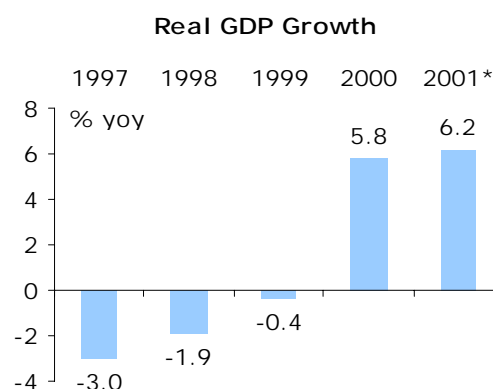
During the technical consultations preceding the official bilateral negotiations, Ukraine failed to agree upon restructuring of its debt to Turkmenistan for supplied natural gas (around USD 282 m) on terms similar to than in the Paris Club agreement. Prime Minister Anatoliy Kinakh said that Ukraine is ready to ease the terms of the debt restructuring for Turkmenistan, which wants the debt to be repaid in 3.5 years, starting from 2001. However, under the Ukraine-Paris Club agreement, the debt to Turkmenistan cannot be restructured under more favourable terms than that of other countries.

President Leonid Kuchma has vetoed the moratorium, passed by the Parliament in July, concerning the sale of debt-ridden companies the state ownership in which exceeds 25%. He also vetoed the law on the State Property Fund (SPF), according to which the SPF is accountable to the Parliament and controlled by it, except for cases regarding state property management which the Cabinet would supervise. Meanwhile, the subordination of the SPF is ambiguous.

## Real economy: The boost in value added in agriculture exceeds the growth paths in other sectors

The January to July 2001 growth of real GDP reached its highest level – 10.5% yoy cum. (17.4% yoy in July) since the beginning of Ukraine's economic recovery. Compared to the steady value added increases in other sectors, value added in agriculture and forestry rose by 24.6% yoy cum. in seven months mainly due to a good grain harvest.

The slowdown of growth in the industrial sector persisted: From January to July industrial output increased by 17.9% yoy cum. as compared to 18.5% yoy cum. for the first half of the year and 18.8% yoy cum. for January to May. According to the State Statistics Committee (Derzhkomstat), about 98% of produced industrial goods were sold during the first half of year (shipped, according to Derzhkomstat terminology) indicating positive demand trends. This should mean insignificant inventory changes within this period.



Source: Derzhkomstat  
\* official forecast

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In the first seven months of 2001 real wages grew by 17.7% yoy cum. However, wage arrears were still rather high: UAH 4.2 bn as of July 10 (UAH 1.73 bn in industry and UAH 1.47 bn in agriculture).

### Sectoral trends: Privatisation receipts are below budgeted values

**Privatisation.** State budget revenues from privatisation continued to fall. According to the State Property Fund (SPF), privatisation receipts reached 58% of plan for January-July, and were further slackening in August. The SPF and Cabinet of Ministers will not accelerate the sale of Ukrtelecom in 2001; hence, it will not be sold this year. To compensate the shortfall in privatisation receipts, the Cabinet of Ministers released 50% of state shares in 6 enterprises for the sale, in addition to blocking packages in 12 enterprises released earlier.

**Energy sector.** In July-August 2001 the level of cash payments by the energy distributing companies (oblenergos) to the wholesale electricity market increased compared with the previous month (60.4% in June), returning to the March-May level of 70%. In June 2001, nearly 76% of all indebted electricity consumers were disconnected from the electricity supply. However, the largest debtors (holding 61.4% of the total debt) are still being supplied, potentially erasing the positive effects of increased market discipline.

During the first half of 2001, cash payments for gas sharply increased compared to previous periods. 85% of all consumed gas was paid for by cash and through one-day mutual settlements. The corresponding figures for 2000 and 1999 were 45% and 15% respectively. Meagre receipts in the past limited the ability of the NAK Naftogaz Ukrainy to maintain and rehabilitate the gas transport system, now substantially outmoded since Soviet times.

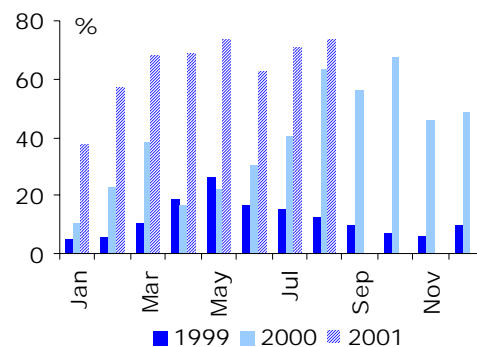
**Agriculture.** A significant increase in crop yields led to increased grain production. This year's grain harvest reached 38 m tons, which is the largest volume since 1993. Ukraine has turned from a net importer to a net exporter of major crops, and decreased domestic prices dramatically (by almost 50%). Total grain exports could reach 5-6 m tons, although mostly feed cereals due to the low grain quality. Unfortunately this production boom is not supported by infrastructure improvements. Low Ukrainian port capacities and logistics problems still tend to suppress domestic prices and increase the cost of exporting.

### External Sector: Despite the economic upturn, the FDI inflow remained low

In the first half of this year, Ukraine's merchandise trade turnover grew by 14.4% yoy cum. posting a surplus of USD 539.4 m, compared to a USD 320.9 m deficit in the first half of 2000. Exports grew much faster than imports, by 21.7% yoy cum. and 7.4% yoy cum. respectively. However, as of August 24 the United States has suspended the preferential duty-free status for Ukrainian-made goods because Ukraine still tolerates the illegal reproduction of audio/video and software products. The USA also threatened to impose more sanctions, which might raise the losses to Ukrainian exporters to USD 200 m per year. The continuing real appreciation of the hryvna and recently introduced less favourable trading rules with Russia heighten the misgivings of Ukrainian exporters.

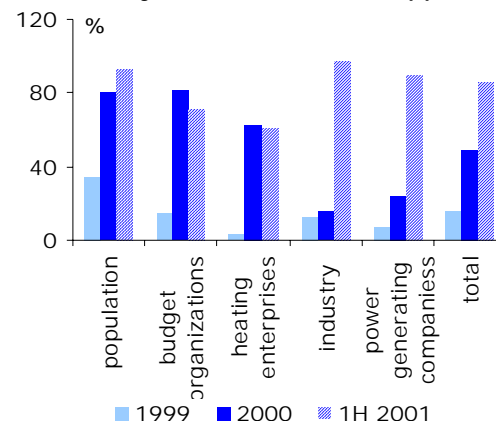
The net inflow of foreign direct investment (FDI) into Ukraine amounted to USD 269 m during the first half of the year, which is 20% lower than during the first half of 2000. Nevertheless, the well-sustained economic growth in Ukraine burns positive expectations concerning high FDI inflows in the nearest future. The cumulative FDI since independence reached USD 4.06 bn.

Cash payments by oblenergos as % of electricity supply



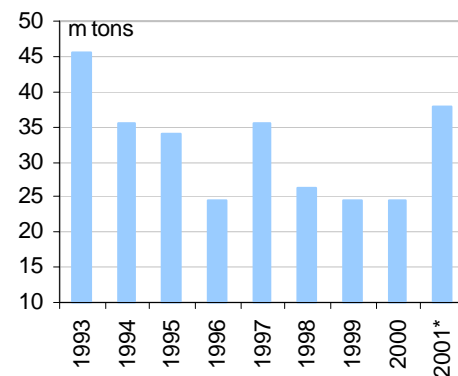
Source: NERC, Interfax

Cash Payments to NAK Naftogaz Ukrainy as % of amount supplied



Source: Ministry of Economy of Ukraine

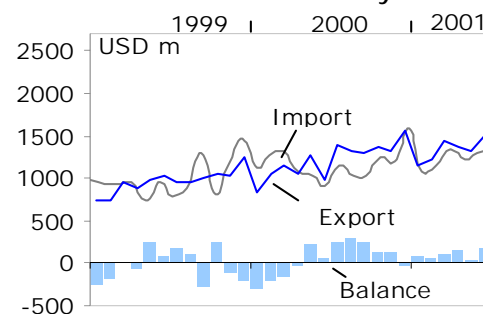
Grain production in Ukraine



Source: Derzhkomstat, Business week

\* preliminary estimations

Merchandise Trade Dynamics



Source: Derzhkomstat

## Fiscal policy: Tax and non-tax revenues compensate for the failure of the privatisation performance

Consolidated budget surplus of UAH 1.7 bn has been reached in the first seven months of fiscal 2001. 57.1% of the year's budgeted revenues have been received. Higher tax and non-tax revenues, resulting from the strong GDP growth, a reduction in non-monetary transactions and positive trends in exports have compensated for the poor performance in the privatisation area.

However, expected lower economic growth in the second half of 2001 may prevent reaching the budgeted revenue target, raising the need to look for other revenue sources. Besides, some industries (mainly the energy and fuel sector, agriculture, and transport) continue to accumulate tax arrears.

## Monetary policy: The spread between average credit and deposit rates has significantly decreased

In August 2001 the NBU reduced the discount rate from 19% to 17% p.a. This is the fourth reduction since January 2001, resulting in an overall discount rate reduction by 10 percentage points.

However, the average deposit rate on deposits in national currency holdings in commercial banks increased to 14.2% p.a., reaching the highest level since September 2000. At the same time the average credit rates for hryvna-denominated commercial bank credits declined from 37% to 31% p.a. since the beginning of the year. The decrease in spread between credit and deposit rates may reflect an increasing efficiency of financial intermediation. However, so far credits and deposits show only minor growth.

According to the NBU, the monetary base enlarged by 22.3% cum. (32.5% yoy) in January-August 2001. Yet, the inflation in August comprised -0.2% mom (9.6% yoy), and totalled 3.3% cum. since the beginning of 2001. A low level of inflation during the summer months is typical for Ukraine, reflecting a stable seasonal pattern.

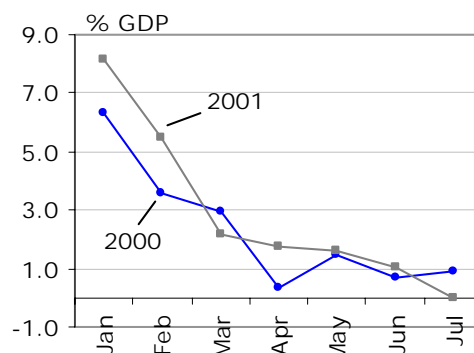
The NBU continued to sterilise the money creation, and in August it sold nearly UAH 684 m in percentage state domestic bonds (POVDP) and UAH 4 m in NBU deposit certificates. The total sum of sterilisation (UAH 687.6 m) grew by 15% compared to the previous month, supporting the policy of short-term price stability in Ukraine. Potentially, the POVDP may become an important NBU instrument for managing the money supply.

## Financial markets: GDP growth helped to increase the credit worthiness of Ukraine – risk premium on Ukrainian Eurobonds fell

**External debt market.** The yield to maturity on the Ukrainian Eurobonds denominated either in EURO with a coupon interest of 10% or in USD with a coupon interest of 11% has decreased substantially since the beginning of the year. This decline of the rate of return implies an improving perceived credit risk of Ukraine, resulting from a sustained GDP growth, a current account surplus, and balanced budgets in 2000 and in the first half of 2001.

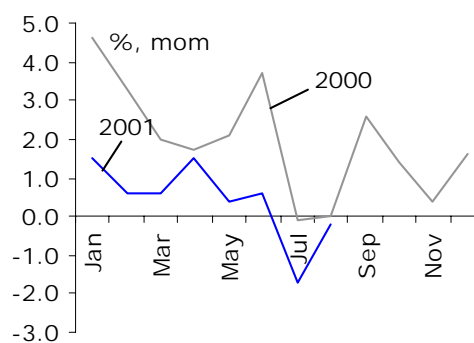
**Banking sector.** The large state-owned participants in the financial market, Oschadbank and Ukrposhta, tried to use their widespread branch systems for development of new projects. Ukrposhta has launched a pilot project for money transfers through Western Union, so far in Kyiv and in six other large cities. Assuming a successful start, Ukrposhta is planning to institute large-scale international money transfers by the end of the year. Oschadbank is expected to start up its own credit card processing centre by late September 2001. That would allow Oschadbank to conduct several pilot projects with the Europay International payment system.

Consolidated budget balance, cum.



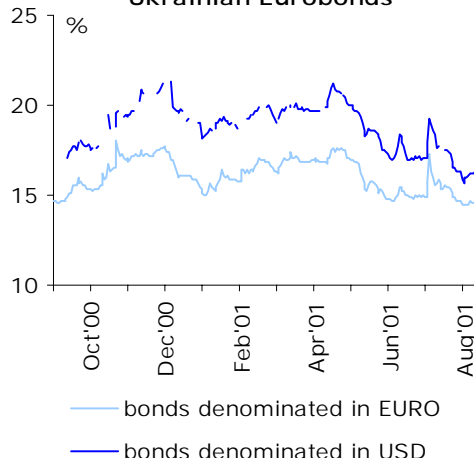
Source: State Treasury reports (Privatization receipts included, Pension Fund excluded)

Change in CPI, monthly



Source: Derzhkomstat

Yields to Maturity on the Ukrainian Eurobonds



Source: own calculations



## Economic Trends

|                                |             | Q2 00 | Q3 00 | Q4 00 | Q1 01 | Q2 01 | May   | June  | July | August |
|--------------------------------|-------------|-------|-------|-------|-------|-------|-------|-------|------|--------|
| GDP growth (real)              | % yoy       | 4.5   | 5.1   | 7.9   | 7.7   | 10.3  | 10.9  | 9.2   | 17.4 | ...    |
| GDP growth (real)              | % yoy cum.  | 4.9   | 5.5   | 5.8   | 7.8   | 9.1   | 9.0   | 9.1   | 10.5 | ...    |
| Industrial production (real)   | % yoy cum.  | 11.0  | 11.8  | 12.9  | 17.4  | 18.5  | 18.8  | 18.5  | 17.9 | ...    |
| Agricultural production (real) | % yoy cum.  | -4.6  | 6.8   | 9.8   | 6.1   | 5.8   | 6.1   | 5.8   | 26.5 | ...    |
| CPI                            | % yoy eop   | 30.3  | 31.7  | 25.8  | 17.3  | 11.6  | 15.1  | 11.6  | 9.9  | 9.6    |
| PPI                            | % yoy eop   | 22.6  | 19.9  | 20.8  | 12.8  | 9.4   | 10.1  | 9.4   | 7.9  | ...    |
| Exports (gs, USD)              | % yoy cum.  | 16.4  | 20.1  | 20.3  | 15.1  | ...   | 20.6" | 21.7" | ...  | ...    |
| Imports (gs, USD)              | % yoy cum.  | 19.8  | 16.0  | 18.9  | 3.1   | ...   | 2.6"  | 7.4"  | ...  | ...    |
| Merchandise trade balance      | USD bn cum. | -0.10 | 0.62  | 0.78  | 0.24  | ...   | 0.42" | 0.59" | ...  | ...    |
| Current account                | USD bn cum. | 0.29  | 1.19  | 1.48  | 0.28  | ...   | ...   | ...   | ...  | ...    |
| Current account                | % GDP       | 6.3   | 9.7   | 3.0   | 3.5   | ...   | ...   | ...   | ...  | ...    |
| Official reserves, excl. gold  | USD bn eop  | 0.81  | 0.83  | 1.35  | 1.40  | ...   | ...   | ...   | ...  | ...    |
| Monetary Base                  | % yoy eop   | 35.7  | 34.5  | 39.9  | 33.1  | 35.4  | 29.5  | 35.4  | 30.2 | 32.5   |
| Lending rate on UAH credits ** | % pa, eop   | 39.7  | 39.7  | 37.3  | 33.8  | 32.1  | 26.3  | 26.3  | 31.3 | 31.7   |
| Exchange rate (official)       | USD aop     | 5.42  | 5.44  | 5.44  | 5.43  | 5.41  | 5.41  | 5.40  | 5.37 | 5.35   |
| Exchange rate (official)       | EUR aop     | 5.06  | 4.93  | 4.73  | 5.02  | 4.73  | 4.76  | 4.61  | 4.62 | 4.81   |

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

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

quarterly figures are based on the NBU official publications

\* 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  | 31.8  |
| GDP growth (real)                 | % yoy     | -12.2 | -10.0 | -3.0 | -1.9  | -0.4  | 5.8   |
| Industrial production             | % yoy     | -12.0 | -5.1  | -0.3 | -1.0  | 4.0   | 12.9  |
| Agricultural production           | % yoy     | -3.6  | -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 | 376.4 | 80.2  | 15.9 | 10.6  | 22.7  | 28.2  |
| CPI                               | % yoy eop | 181.7 | 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 | -7.3  | 20.3  |
| Imports (gs, USD)                 | % yoy     | -4.0  | 24.2  | 2.0  | -14.0 | -19.1 | 18.9  |
| 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  | 1.7   | 1.5   |
| Current account                   | % GDP     | -3.1  | -2.7  | -2.7 | -3.1  | 5.3   | 4.7   |
| 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   | 5.2   | 5.1   |
| Real exchange rate (CPI defl.)    | % yoy eop | 32.5  | 31.0  | 9.8  | -14.5 | -20.1 | 12.9  |

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

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

\* Forecast

## Notes:

**aop** average of the period  
**avg** average  
**bp** basis points  
**cum.** cumulative  
**mom** month over month change

**p.a.** per annum  
**eop** end of the period  
**gs** goods and services  
**yoy** year over year change