Monthly Economic Monitor Ukraine

- Both the IMF and the World Bank resumed their financing programmes to Ukraine, thereby opening the way for Ukraine's debt restructuring process with other countries.
- The official forecast of real GDP growth for 2001 was revised upward to 7.3% yoy, supported by a 10.8% yoy GDP growth for the first eight month of 2001.
- The recently adopted "Ukrainian Coal" programme envisages increased state financing for the coal sector and privatisation of coal mines.
- A draft of the 2002 Budget Law was submitted to Parliament.
- The NBU introduced a 5% limit on foreign currency exchange rate fluctuations for cash transactions.

No.10 (12)
October
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: International financial organisations resumed loans to Ukraine

On September 20 the IMF resumed financing to Ukraine under the Extended Fund Facility programme and reimbursed USD 376.6 m as a first tranche. Following the IMF's decision, the World Bank extended USD 250 m of the First Programmatic Adjustment Loan (PAL-1), out of which USD 150 m was disbursed immediately. This disbursement of loans allowed the Ministry of Finance to start official negotiations with individual Paris Club member countries on debt restructuring in accordance with the agreement made in July 2001 with the Paris Club. The renewal of financing should improve Ukraine's creditworthiness on international markets.

To prevent possible trade sanctions by the USA, which could cause a USD 630 m loss in Ukrainian export revenues, Parliament passed a law in first reading designed to stop pirate laser media production. Still, some parliamentarians argued that the law would hurt the domestic CD production industry and would be ineffective in the fight with pirate producers. Meanwhile the USA postponed the introduction of trade sanctions against Ukraine for two weeks. The final American decision will depend on whether the law passes through second and third readings in Parliament.

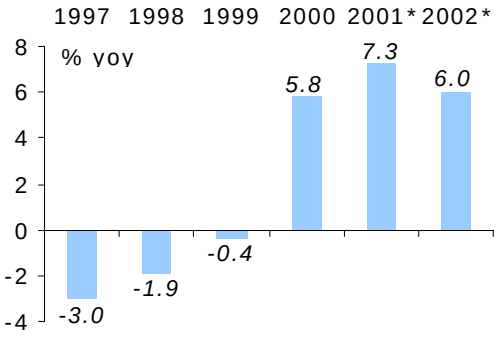
Real economy: The official forecast of real GDP growth for 2001 was again revised upward

According to Derzhkomstat, the real GDP grew by 10.8% yoy between January and August 2001 (in August – 12.4% yoy) somewhat slowing the rate of growth compared to previous months. Growth in value added to agriculture and forestry remained high at 26.2% yoy for the first eight months, but stable when compared to July. Increasing growth in value added in the wholesale and retail trades and in repair services (15.9% yoy cum.) was offset by a slowdown in value added growth in construction and in the manufacturing industry.

According to an official forecast of the Ministry of Economy, the real GDP should increase by 7.3% in 2001 and by 6.0 % in 2002. The growth forecasts are based to a large extent on anticipated increase in real private consumption and investment. At the beginning of 2001, the real GDP forecast was for 4% growth, later upgraded to 6.2%. During August 2001, the real monetary income of households increased by 8% mom, which helped to support the domestic demand-driven side of economic growth. In addition, total wage arrears continued to decline (11.5% mom in August) diminishing to UAH 3.4 bn as of September 10.

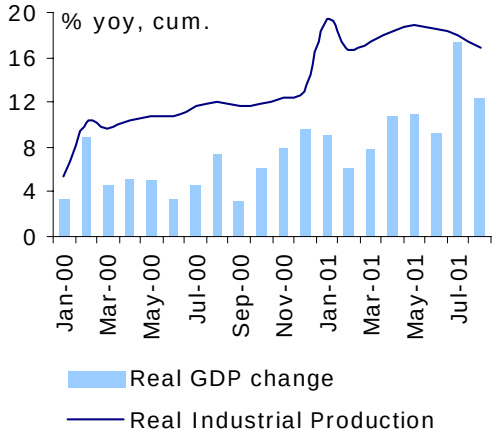
Notwithstanding the economic recovery, nearly 45% of all Ukrainian enterprises were making losses between January and July 2001. The amount of profit generated by Ukraine's enterprises was 2.6 times higher than the losses. 63% of the losses concentrated in industry.

Real GDP Growth



Source: Derzhkomstat
* official forecast by the Cabinet of Ministries

Real Output Growth



Source: Derzhkomstat

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Sectoral trends: The Cabinet intends to extend financing to the coal industry

Energy sector. The Cabinet of Ministers approved a ten year "Ukrainian Coal" programme (2001-2010), which envisages the privatisation of profitable and of potentially profitable coal mines as well as the gradual closure of the largest loss-making mines and a substantial increase of state support for the industry. According to the program's provisions, financing the coal industry out of state coffers should increase almost three times in 2002. Virtually, the program does not lead to an abolishment of cross-subsidisation, hampering efficient restructuring within the industry and the general economy.

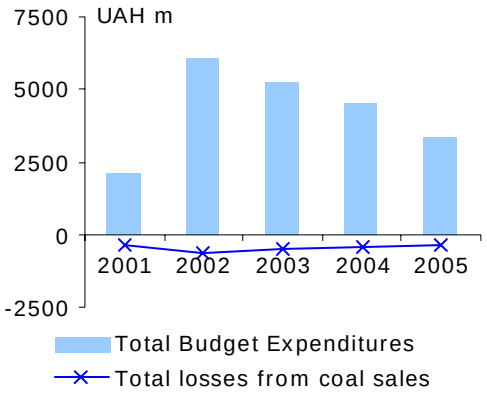
National Electricity Regulation Commission (NERC) has postponed the enforcement of a new methodology for electricity tariff setting, which was enacted in April 2001 to meet the requirements of the new private owners of regional distribution companies (oblenergos). This methodology envisages rate-of-return regulation and would lead to substantial tariff increases. However, further postponement of tariff increase endangers current investment plans of the new owners and future privatisation process in this sector.

Privatisation. According to the State Property Fund, fiscal revenues from privatisation reached UAH 1.77 bn (or 50.9% of the planned amount) for the period of January to August 2001. Suspension of privatisation in the energy sector, which is unlikely to be resumed before the end of 2001, is claimed to be the main reason for low fiscal revenues. The preferential sale of a 13% stake in Ukrtelecom to its employees between October 1 and December 1, 2001 is supposed to generate UAH 180 m in revenues. The Cabinet of Ministers also approved the sale of 25% of Ukrtelecom's stake in the Ukrainian mobile phone operator (UMC) to be completed prior to the end of 2001.

Agriculture. In September, the prices on the Ukrainian grain market stabilised at a much lower level than world market prices. Some administrative restrictions, failure to privatise export facilities including port elevators as well as an exceptionally good grain harvest put pressure on local market prices.

Prime Minister Anatoly Kinakh announced a new policy intended to reduce government intervention on the grain market. Instead of trying to prevent low grain prices, it is planned to develop infrastructure and support exports. Still, the state plans to increase financing to the agricultural sector by 40% in 2002 compared to the current year. The government will continue subsidising the interest rates on lowns to agriculture and partially compensating for crop insurance premiums and for interest rates for leasing.

Coal Industry Financing According to the Program "Ukrainian Coal"



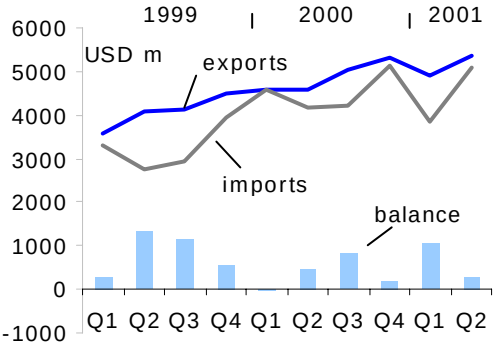
Source: Program "Ukrainian Coal"

External Sector: The influence of CIS countries on Ukrainian trade remains high

According to the NBU, imports grew by 7.2% yoy cum., while exports increased by 17% yoy cum during the first half of 2001. The trade surplus reached USD 486 m. Based on Derzhkomstat data, Ukraine remains dependant on imports of goods and services from the CIS countries despite a slight decline in their share, from 56.7% for January to June 2000 to 55.3% for the same period in 2001. At the same time, strong economic growth within the CIS countries supported increases of their shares in Ukraine's exports, which grew to 37.9% compared to the 35.6% in the first half of the previous year.

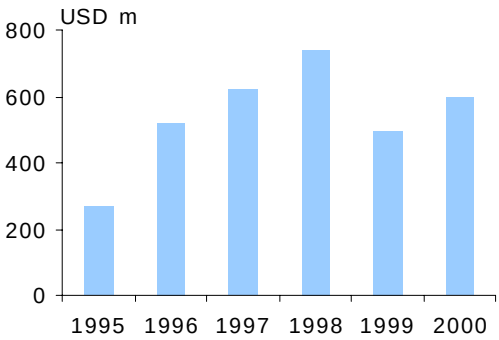
According to newly published NBU figures, foreign direct investment (FDI) into Ukraine rose to USD 515 m during the first half of 2001, which is 55% higher than for the corresponding period of 2000. These data sharply contradict previously published figures by Derzhkomstat, which showed a 20% yoy decline over the same period. According to these new data, the cumulative amount of FDI since independence has reached USD 4.4 bn.

Dynamics of Ukraine's Foreign Trade in Goods and Services



Source: NBU

Net FDI Inflows to Ukraine



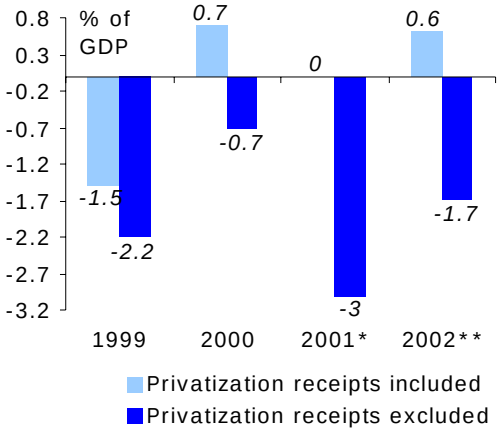
Source: NBU

Fiscal policy: The draft of Budget 2002, based on a new methodology, was submitted to Parliament

By August 2001 the central fiscal surplus had reached UAH 807.6 m, a bit less than the 2000 figure (UAH 992.0 m). The writing off of tax debts and slow privatisation are the major threats to reaching this year's revenue targets.

On September 14, the Government submitted a draft of the 2002 Budget Law to Parliament. In accordance with the newly adopted methodology, which presents privatisation receipts as deficit financing instead of as a revenue item, the consolidated 2002 budget deficit is stipulated at 1.7% of GDP. Nevertheless, even if privatisation receipts for 2002 are very modest, it will be enough to cover the planned deficit. The new programme targeted approach to fiscal expenditures, almost 52% of which will be directed towards social programmes, was introduced to ensure efficiency of state spending. Anticipating a continuation of economic growth in 2002, the government based its budget calculations on 6% real GDP growth, a 9.8% inflation rate and an average exchange rate of 5.6 UAH/USD.

Consolidated Budget Balance

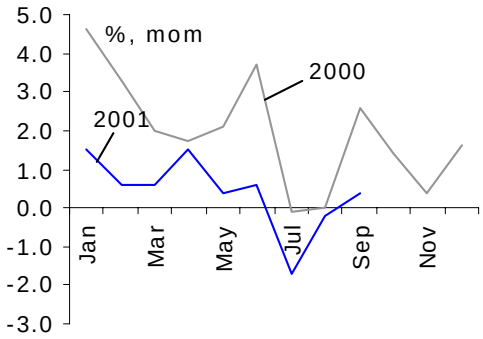


Source: State Treasury reports (Pension Fund excluded),
* - Law on State Budget 2001
** - Draft of Law on State Budget-2002

Monetary policy: The NBU adopted a tighter monetary policy for 2002

In September 2001, the Council of the NBU adopted the guideline "Basis of Money and Credit Policy for 2002", stipulating a tighter monetary policy for next year. This policy is directed at sustaining low inflation, a stable hryvnia, and ensuring a healthy development of the banking system. In September the inflation rate stood at 7.3% yoy (0.4% mom), totalling 3.7% cum. since the beginning of 2002.

Change in CPI, monthly



Source: Derzhkomstat

Financial markets: The NBU introduced regulations on cash foreign currency exchanges

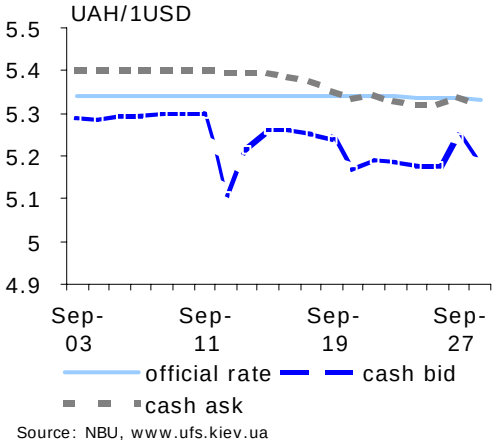
Foreign exchange market. So far the terrorist attacks in the USA did not have any significant impact on the non-cash foreign exchange market in Ukraine. However, the cash currency market reacted with an unjustifiably low exchange rate. For this reason, the NBU restricted the fluctuations of the cash exchange rate to within 5% of the official NBU rate. This is an efficient preventive measure for avoiding speculations at the cash exchange market.

Banking sector. The Ukrainian commercial banks reported a net profit of UAH 370 m for the first eight months of 2001, a more than three-fold increase from the corresponding period of last year. Another very positive development was that long-term credit grew faster than short-term credit in August, reflecting positive expectations of the financial market.

The payments by the German and Austrian foundations to former forced labourers of Ukraine has successfully started in August 2001 and should last for about three years. In order to facilitate the investment of about DEM 2 bn by the recipients of this money, the NBU has authorised commercial banks to open special accounts for them, without the usual requirement of a tax identification number. The NBU is also considering issuing "currency certificates of deposit" for the same purpose. These measures are directed at expected increased investment inflows from the former "Ostarbeiter".

External debt market. Following the September 11 events in the U.S. and the ensuing shock waves on the global markets, the quotations for Ukrainian Eurobonds became shaky, initially falling by 6%, but recovering almost completely shortly after. On September 14 the Finance Ministry of Ukraine made interest and principal payments on the seven-year Eurobonds amounting to EUR 63.4 m and USD 67.1 m. Assuming that the upcoming world recession might affect Ukraine less than the Central European economies, and considering that the first bond servicing was strictly on time, the attractiveness of Ukraine's bonds for foreign investors may rise.

Nominal Exchange Rate in September



Source: NBU, www.ufs.kiev.ua

Economic Trends		Q2 00	Q3 00	Q4 00	Q1 01	Q2 01	June	July	August	Sept
GDP growth (real)	% yoy	4.5	5.1	7.9	7.7	10.3	9.2	17.4	12.4	...
GDP growth (real)	% yoy cum.	4.9	5.5	5.8	7.8	9.1	9.1	10.5	10.8	...
Industrial production (real)	% yoy cum.	11.0	11.8	12.9	17.4	18.5	18.5	17.9	16.9	...
Agricultural production (real)	% yoy cum.	-4.6	6.8	9.8	6.1	5.8	5.8	26.5	27.7	...
CPI	% yoy eop	30.3	31.7	25.8	17.3	11.6	11.6	9.9	9.6	7.3
PPI	% yoy eop	22.6	19.9	20.8	12.8	9.4	9.4	7.9	7.1	...
Exports (gs, USD)	% yoy cum.	16.4	20.1	20.3	15.1	17.0	21.7''	19.9''	...	...
Imports (gs, USD)	% yoy cum.	19.8	16.0	18.9	3.1	7.2	7.4''	8.7''	...	...
Merchandise trade balance	USD bn cum	-0.10	0.62	0.78	0.24	0.29	0.59''	0.73''	...	...
Current account	USD bn cum	0.29	1.19	1.48	0.28	0.57	...	...	...	...
Current account	% GDP	6.3	9.7	3.0	3.5	7.2	...	...	...	...
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	35.4	30.2	32.5	37.2
Lending rate on UAH credits **	% pa, eop	39.7	39.7	37.3	33.8	32.1	26.3	31.3	31.7	30.7
Exchange rate (official)	USD aop	5.42	5.44	5.44	5.43	5.41	5.40	5.37	5.35	5.33
Exchange rate (official)	EUR aop	5.06	4.93	4.73	5.02	4.73	4.61	4.62	4.81	4.87

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

'' Monthly figures are only for merchandise exports and imports (source: Derzhkomstat).
Quarterly figures are for trade in goods and services (source: NBU).

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

Key Economic Indicators		1995	1996	1997	1998	1999	2000	2001F	2002F
Nominal GDP	USD bn	37.0	44.6	50.2	41.9	31.6	31.8	38.5	43.0
GDP growth (real)	% yoy	-12.2	-10.0	-3.0	-1.9	-0.4	5.8	7.3	6.0
Industrial production	% yoy	-12.0	-5.1	-0.3	-1.0	4.0	12.9	14.3	7.0
Agricultural production	% yoy	-3.6	-9.5	-1.9	-9.8	-6.9	9.2	10.0	3.8
CPI	% yoy aop	376.4	80.2	15.9	10.6	22.7	28.2	14.3	11.3
CPI	% yoy eop	181.7	39.7	10.1	20.0	19.2	25.8	12.3	9.8
PPI	% yoy aop	488.9	52.1	7.7	13.2	31.5	20.9	10.3	9.4
PPI	% yoy eop	172.1	17.3	5.0	35.4	16.0	20.8	7.0	6.5
Exports (gs, USD)	% yoy	2.6	19.1	0.0	-13.4	-7.3	17.9	7.9	5.7
Imports (gs, USD)	% yoy	1.5	17.4	2.0	-14.0	-19.1	18.9	9.9	6.6
Current account	USD bn	-1.2	-1.2	-1.3	-1.3	1.7	1.5	1.0	1.0
Current account	% GDP	-3.1	-2.7	-2.7	-3.1	5.3	4.7	2.6	2.3
FDI (net)	USD bn	0.3	0.5	0.6	0.7	0.5	0.6	0.8	1.1
Gross official reserves, net gold	USD bn	1.0	2.0	2.3	0.8	1.0	1.4	...	...
Fiscal balance	% GDP	-6.6	-4.9	-6.6	-2.2	-1.5	0.7	...	...
Fiscal balance (IMF methodology)	% GDP	...	...	...	...	...	-0.8	-2.0	-1.7
Total public debt	% GDP eop	40.9	25.0	30.3	49.4	61.4	44.5	...	...
External debt (total)	% GDP eop	26.3	20.5	19.4	38.4	50.0	32.5	...	...
Monetary base	% yoy eop	132.3	38.0	44.6	21.9	39.3	39.9	18 - 19	11 - 13
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	...	...

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)

F means official forecast of the Ministry of Economy

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