Monthly Economic Monitor Ukraine

- Volodymyr Lytvyn, a leader of the bloc "For United Ukraine" and former Head of the President's Administration, became the new speaker of Parliament.
- Ukraine received the status of observer in the Eurasian Economic Community (EURASEC).
- Investments in fixed capital decelerated to 9.6% yoy in the first quarter of 2002 compared to 23.7% yoy during the same period of 2001.
- The Cabinet of Ministers finally approved the privatisation terms for Ukrtelecom.
- In May 2002, the month-on-month change of the consumer price index was negative, resulting in a new slowdown in inflation to the 1.4% yoy level.
- The Cabinet of Ministers approved the criteria for determining suspicious financial transactions, which commercial banks must report to the authorities.

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Population: 48.4 m
Industry/GDP: 30.9%
Agriculture/GDP: 14.7%
Investment/GDP: 20.4%
Exports destination: Russia 22%, EU 17%
Imports origin: Russia 34%, EU 20%

Politics: The new speaker of Parliament is Volodymyr Lytvyn, the leader of the bloc "For United Ukraine"

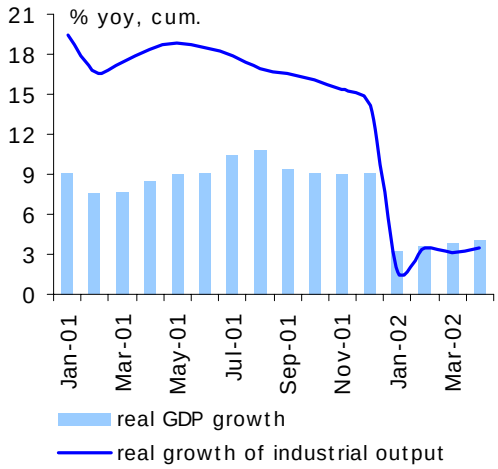
Two weeks after the inaugural session, Parliament has finally elected Volodymyr Lytvyn, the leader of the bloc "For United Ukraine" and former Head of the President's Administration, as speaker. The first vice-speaker became Henadiy Vasyliev, also a member of the bloc "For United Ukraine", while a representative of Social-Democratic Party (United), Oleksandr Zynchenko, was chosen as a vice-speaker. This group of nominees was proposed by the bloc "For United Ukraine" and the Social-Democratic Party (United) and received 226 votes, the exact minimum needed for their election. The next hot issue in Parliament will be selecting the committee chairmanship positions.

On May 31 President Leonid Kuchma sent two Addresses to Parliament. One, entitled "The European Choice", presented a new strategy for Ukraine's social and economic development, and the other concerning "The Domestic and Foreign Situation of Ukraine in 2001". A major goal of the proposed strategy is the establishment of a strong state through strengthening of the state's regulatory functions, while simultaneously reinforcing the market-oriented development of the country. The address also postulated that Ukraine would be a member of the WTO by 2003, and that by 2011 it will have created the preconditions for EU membership.

In mid-May Ukraine received the status of observer in the Eurasian Economic Community (EURASEC), consisting of Russia, Belarus, Kazakhstan, Kyrgyzstan, and Tajikistan. The Russian Prime-Minister Mikhail Kas'yanov promised to eliminate VAT for crude oil exports to Ukraine and to establish free trade between both countries in case of Ukraine's adhesion to EURASEC. The idea of membership in EURASEC found strong support among some powerful business groups inside Ukraine, interested in free trade with Russia.

IMF and World Bank (WB) missions have been working in Ukraine during May. The IMF mission is likely to recommend to the IMF Board of Directors to resume the next two tranches of USD 550 m in July, provided that Ukraine closes the fiscal gap and resolves the VAT problems. At the same time, the WB is ready to allot the second tranche of USD 250 m to Ukraine under its Programmatic Adjustment Loan in September, if Ukraine meets its 2002 budget goals, privatises the regional power distribution companies, restructures Oschadbank, and establishes a property registration agency.

Real Growth of GDP and Industrial Output



Source: Derzhkomstat

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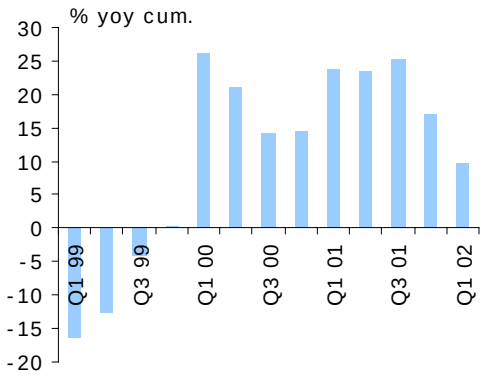
Real economy: The growth of the real GDP was maintained, although investments decelerated

The growth of the real GDP was maintained at the 4.1% yoy level during the first four months of 2002. As before, manufacturing, agriculture, and trade contributed most to this increase. Industrial production grew by 3.5% yoy in January-April 2002 mainly due to rises in the food sector, machine building, and the coke and petroleum processing industries. At the same time, metallurgy and metal processing, cornerstones of industrial growth in the first half of 2001, declined by 6.6% yoy cum. In May, the Cabinet of Ministers finally adopted a list of those metal and ore-mining enterprises, benefiting from the privileged profits tax in accordance with the January law, which allows 50% of an enterprise's profit tax receipts to be accumulated in a special investment account in the State Treasury.

Despite the slowdown in economic growth, real wages continued to grow at a 19.1% yoy rate during the first four months of the year. At the same time, investment in fixed capital decelerated to 9.6% yoy in the first quarter of 2002 compared to 23.7% yoy in the same period in 2001. Though the share of state investment decreased, they were partially offset by investment funded by private and collective property. This slowdown of investment activity vis-à-vis increases in wages - i.e. high consumption today at the expense of the future - could undermine Ukrainian economic growth over the long-term.

Investment in Fixed Capital



Source: Derzhkomstat

Sectoral trends: The conditions for Ukrtelecom's privatisation have been finally approved

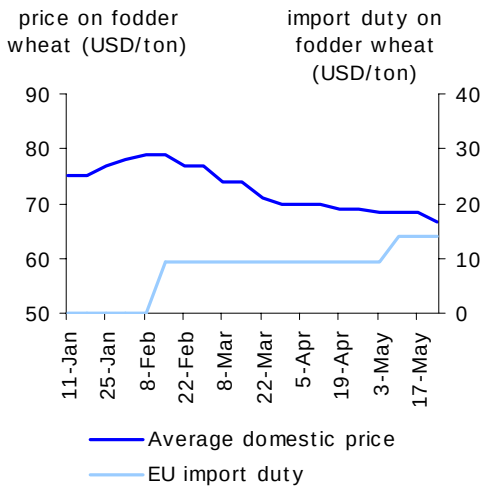
Infrastructure. The Cabinet of Ministers has finally approved the terms of privatisation for Ukrtelecom. The conditions are: a potential bidder must have had at least USD 1 bn revenues from telecommunications operations within the past three years, at least 2 m fixed or mobile subscribers, and at least a five-year presence on the telecommunications market. Initially the nominal value of the 37% stake was estimated at UAH 1.7 bn. However, it is very likely that the stake for sale will be increased to 42.9% by including those shares, which remained unsold during the privileged subscription.

It is still unclear however whether the 25% state package in UMC, controlled by Ukrtelecom and valued UAH 500 m, will be sold before Ukrtlecom's privatisation. Failure to sell UMC before Ukrtelecom may alter the price of the latter, and it makes the privatisation more uncertain.

Privatisation. Privatisation receipts as a deficit-financing item fell short of its January-April target, totalling only UAH 289 m, or 43% of plan. It is very unlikely that the annual target (UAH 5.8 bn) will be met without the sales of Ukrtelecom and regional power distribution companies (oblenergos).

Agriculture. At the beginning of May 2002, the EU further increased tariff duty on low-quality wheat exported from Eastern Europe. The higher tariff has partially influenced the price of fodder wheat in Ukraine, which dropped by 16% from February to May 2002. Although the government of Ukraine addressed a request to the EU to reduce this protectionist measure, no response has yet been received. For Ukraine, lower prices on the domestic market means both potential losses for wheat producers and cheaper fodder for cattle breeding.

EU Import Duty and Ukraine's Domestic Price on Fodder Wheat in 2002

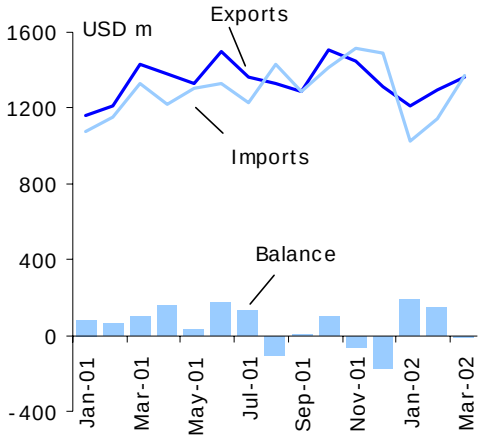


Source: UkrAgroConsult, EU Commission

External Sector: Moldova might impede Ukraine's WTO membership

Moldova suspended its sugar exports to Ukraine in response to Ukraine's exemption of Moldavian sugar from the free trade regime. Other possible measures against Ukraine were postponed until the June round of Ukraine's negotiations for WTO membership.

Merchandise Trade Dynamics

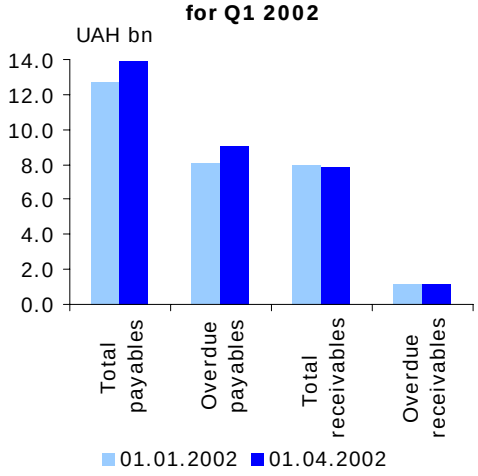


Source: Derzhkomstat

Moldova, as a member of Ukraine's WTO Working Party, might impede Ukraine's acceptance into the WTO.

According to the Derzhkomstat, the positive merchandise trade balance was maintained during the first quarter of 2002, although its growth decelerated in year-on-year terms. The growth of exports was 1% yoy cum., while imports declined by 1.2% yoy cum. The lower export increase can be attributed to a further reduction of metallurgy and chemistry exports, only partially offset by increased grain exports.

Dynamics of Payables to and Receivables from Budget for Q1 2002



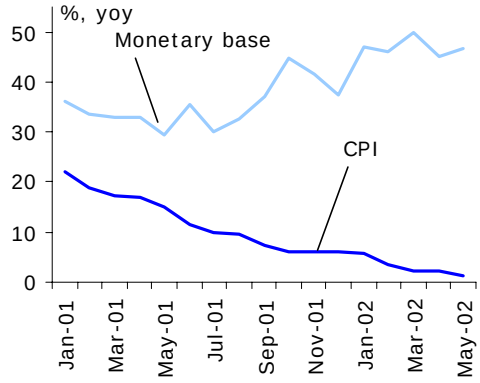
Source: Derzhkomstat

Fiscal policy: The VAT overdue refund debt was reduced by 14% since the beginning of the year

According to State Tax Administration, the overdue VAT refund debt was reduced by UAH 300 m since the beginning of the year, when it stood at UAH 2.1 bn. The reduction of the VAT debt to exporters and improvements to the VAT administration mechanism are among the major directions of the fiscal policy for 2003 as presented in the draft law "Major Directions of Fiscal Policy for 2003".

For January-April 2002, the Consolidated fiscal surplus accounted for 1% of GDP, primarily achieved through local budget surpluses. In April, the Central fiscal revenue performed better, collecting 96% of the budgeted amounts, including higher than planned collections of royalties, VAT on imported goods, and excises on domestic goods. However, collection of the enterprise profits tax (EPT) did not improve due to a drop in net profits of enterprises. Moreover, tax arrears for VAT and EPT increased since the start of the year.

CPI and Monetary Base Development



Monetary policy: Inflation registered at a low 1.4% yoy level

In May 2002, the month-on-month change in the consumer price index was negative, resulting in a new slowdown in inflation to 1.4% yoy. This deceleration happened due to price reductions on dairy products and eggs. Low milk prices fuelled calls by dairy producers for stricter regulation of this market. However, no government action has been taken so far.

Credits denominated in national currency increased by 33.8% yoy in May 2002 compared to a 62.8% yoy growth in May 2001. The NBU announced that the liquidity of commercial banks now stands at UAH 1.0 to 1.3 bn, which the NBU does not intend to sterilise. Also, the NBU continues purchases of foreign currencies on the inter-bank foreign exchange market, steadily accumulating international reserves. As of May 17, they amounted to USD 3.16 bn.

Financial markets: In line with FATF policy, criteria for suspicious financial transactions approved

Banking sector. The Cabinet of Ministers approved the criteria for determining suspicious financial transactions, which the commercial banks have to report to the authorities. The Cabinet considers transactions suspicious if they include offshore companies or pre-payments of more than 30% on imported goods and services. Also, non-cash transactions valued at over EUR 50,000; cash transactions of over EUR 10,000 for the opening of a third-person account, and transactions with traveller's checks are listed.

Previously, the State Tax Administration and the NBU had signed an agreement on cooperation in the fight on money laundering, tax evasion, and capital flight. These measures are a part of the government's efforts to remove Ukraine from the list of countries involved in money laundering transactions as defined by the Financial Action Task Force on Money Laundering (FATF).

Liquid International Reserves

Source: NBU, IFS

Government debt market. Merrill Lynch, one of the leading international rating and financial companies, upgraded the outlook for Ukrainian eurobonds from market-weight to overweight. The decision was taken following the progress in negotiations between Ukraine and the IMF, and because of higher than expected political stability.

Economic Trends		Q1 01	Q2 01	Q3 01	Q4 01	Q1 02	Feb	Mar	Apr	May
GDP growth (real)	% yoy	7.8	10.8	10.7	...	3.8	4.0	4.1	5.0	...
GDP growth (real)	% yoy cum.	7.8	9.4	10.0	9.1	3.8	3.6	3.8	4.1	...
Industrial production (real)	% yoy cum.	17.4	18.5	16.6	14.2	3.1	3.5	3.1	3.5	...
Agricultural production (real)	% yoy cum.	6.1	5.8	8.6	9.9	11.1	10.2	11.1	11.0	...
CPI	% yoy eop	17.3	11.6	7.3	6.1	2.2	3.5	2.2	2.1	1.4
PPI	% yoy eop	12.8	9.4	5.9	0.9	-0.5	-0.2	-0.5	0.5	2.0
Exports (USD)*	% yoy cum.	15.1	16.0	11.3	9.5	...	3.9''	1.0''	...	...
Imports (USD)*	% yoy cum.	3.1	12.3	14.4	14.1	...	-3.1''	-1.2''	...	...
Merchandise trade balance	USD bn cum.	0.16	0.44	0.40	0.20	...	0.34''	0.33''	...	...
Current account	USD bn cum.	0.28	0.85	1.24	1.40	...	...	...	...	...
Current account	% GDP	3.5	5.0	4.4	3.7	...	...	...	...	...
International reserves	USD bn eop	1.52	1.86	2.72	3.09	3.11	3.07	3.11	3.14	...
Monetary Base	% yoy eop	33.1	35.4	37.2	37.4	49.9	46.2	49.9	45.2	46.8
Lending rate on UAH credits **	% pa, eop	33.8	32.1	30.7	29.6	27.7	29.4	27.7	27.0	26.2
Exchange rate (official)	USD aop	5.43	5.41	5.35	5.30	5.32	5.32	5.32	5.33	5.33
Exchange rate (official)	EUR aop	5.02	4.73	4.76	4.74	4.66	4.63	4.66	4.71	4.87

SOURCES: Derzhkomstat, Ministry of Finance, NBU, IFS, own calculations
" Monthly figures are only for merchandise exports and imports (source: Derzhkomstat).
Quarterly figures are for trade in goods and services (source: NBU).
* Growth rate in dollar terms.
** Weighted average for different maturities (source: NBU)

Key Economic Indicators		1995	1996	1997	1998	1999	2000	2001
Nominal GDP	UAH bn	54.5	81.5	93.4	102.6	130.4	173.0	201.9
Nominal GDP	USD bn	37.0	44.6	50.2	41.9	31.6	31.8	37.4
GDP growth (real)	% yoy	-12.2	-10.0	-3.0	-1.9	-0.2	5.9	9.1
Industrial production	% yoy	-12.0	-5.1	-0.3	-1.0	4.0	12.4	14.2
Agricultural production	% yoy	-3.6	-9.5	-1.9	-9.8	-6.9	9.8	9.9
CPI	% yoy aop	376.4	80.2	15.9	10.6	22.7	28.2	12.0
CPI	% yoy eop	181.7	39.7	10.1	20.0	19.2	25.8	6.1
PPI	% yoy aop	488.9	52.1	7.7	13.2	31.5	20.9	8.6
PPI	% yoy eop	172.1	17.3	5.0	35.4	16.0	20.8	0.9
Exports (gs, USD)	% yoy	2.6	19.1	0.0	-13.4	-7.9	17.9	9.5
Imports (gs, USD)	% yoy	1.5	17.4	2.0	-14.0	-19.1	18.9	14.1
Current account	USD bn	-1.2	-1.2	-1.3	-1.3	0.9 °	1.2 °°	1.4
Current account	% GDP	-3.1	-2.7	-2.7	-3.1	2.9	3.8	3.7
FDI (net)	USD bn	0.3	0.5	0.6	0.7	0.5	0.6	0.8
International reserves	USD bn	1.1	2.0	2.4	0.8	1.1	1.5	3.1
Fiscal balance***	% GDP	-6.9	-5.1	-6.8	-2.7	-2.1	-0.7	-1.9
Total public debt	% GDP eop	40.9	25.0	30.3	49.4	61.4	44.5	37.4
External debt (total)	% GDP eop	26.3	20.5	19.4	38.4	50.0	32.5	26.8
Monetary base	% yoy eop	132.3	38.0	44.6	21.9	39.3	39.9	37.4
Exchange rate	USD aop	1.5	1.8	1.9	2.4	4.1	5.4	5.4
Exchange rate	USD eop	1.8	1.9	1.9	3.4	5.1	5.4	5.3
Exchange rate	EUR aop	1.9	2.3	2.1	2.8	4.4	5.0	4.8
Exchange rate	EUR eop	2.3	2.4	2.1	4.0	5.2	5.1	4.7

SOURCES: Derzhkomstat, NBU, IFS, Ministry of Finance, own calculations
NOTE: *** Fiscal balance is calculated in line with new methodology introduced in 2002. "Minus" means budget defici
° The value of goods transferred to Russia according to the inter-governmental agreement reached in May 1997 on the Black Sea Fleet division totaling USD 726 m is not included
°° The value of aircraft complexes transferred to Russia as repayment of a gas debts according to inter-governmental agreement reached in October 1999 totaling USD 274 m is not included.

Notes:

aop	average of period	**p.a.**	per annum
avg	average	**eop**	end of period
bp	basis points	**gs**	goods and services
cum.	cumulative	**yoy**	year-on-year change
mom	month-on-month change	**ytd**	year-to-date