

Monthly Economic Monitor Ukraine

- The new Verkhovna Rada has set up 24 committees and one special control commission.
- The real GDP grew by a modest 3.8% yoy between January and May 2002, compared to 9.0% yoy in the respective period of the previous year.
- Ukraine, Russia, and Germany intend to form a gas transit consortium.
- During the first four months of 2002, exports to Asian countries increased by 35.2%, partially compensating the 30.8% decrease in exports to Russia.
- The significant consolidated fiscal surplus, accumulated during the first four months of 2002, is attributed to lower than planned expenditures by the central government.
- Negative expectations concerning all emerging markets depressed the prices for Ukrainian eurobonds. By the end of June they had recovered, however.

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July
2002**

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: Parliament approved its committee structure

In June the new Parliament approved its committee structure. The Verkhovna Rada now embraces 24 committees and one special control commission on privatisation issues. The newly established committee on European integration issues is the only innovation that distinguishes the current Verkhovna Rada from the previous Parliament. The committee chairman positions were distributed among party factions in proportion to the election results. A member of Victor Yuschenko's "Our Ukraine" faction heads the Budget Committee, and another key committee – on Finance and Banking Activity – is chaired by a representative of the pro-presidential block "For a United Ukraine".

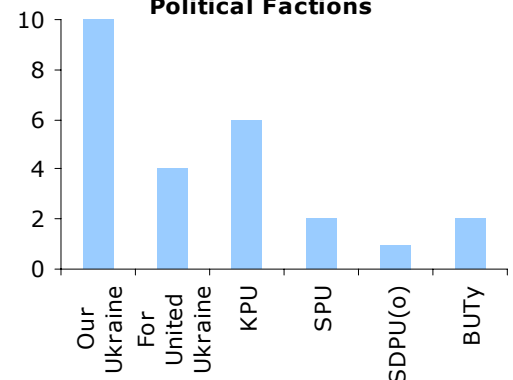
One of the first steps of the Verkhovna Rada was a declaration addressed to parliaments, governments and societies of member countries of the European Union emphasizing that choosing Europe will define the major directions of all political, economic and social reforms of Ukraine. This is the first time since independence that the Parliament of Ukraine declared its intent to pursue Ukraine's membership in the EU and appealed for EU support. Although still remaining at declaration stage, it raises some expectations for elimination of multi-vector foreign policy of Ukraine, for which it was frequently criticised.

In June the Cabinet of Ministers reported to the Parliament on the execution of Budget 2001. The suggestion of the Budget Committee to declare Budget 2001 implementation unsatisfactory did not find enough support. The Parliament also held hearings on budget policy directions for 2003 (Budget resolution). The planned budget deficit, law revenues, incomplete repayments of overdue VAT refund debt, and the inconsistencies of the macroeconomic indicators were the major points of the critique. Voting on the 2003 Budget Resolution is scheduled for July.

Ukraine signed an agreement on restructuring its USD 179 m debt to the United States and the approximately USD 80 m debt to Italy under the terms of the agreement with the Paris Club. Ukraine plans to finish debt restructuring with the Paris Club countries by the end of July; agreements still have to be signed with France and Japan.

The international Financial Action Task Force (FATF), established by the G7, decided not to remove Ukraine from the list of countries that do not do enough to combat money laundering. In June a FATF mission visited Ukraine, and the Ministry of Finance delegation continued talks with the FATF in Paris. In the end, the FATF found it

**Number of Parliamentary
Committee Chairmanships by
Political Factions**



Source: Verkhovna Rada

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unsatisfactory that the law to prevent money laundering in Ukraine had still not been passed by the Parliament.

Real economy: Real GDP growth is lower than expected

The real GDP posted a 3.8% yoy growth in January-May 2002, which is substantially lower than a 9.0% yoy rise in the respective period of the previous year. The lower than expected growth rate of the economy provoked a discussion over the attainability of the officially forecast GDP. According to our estimations, the annual real GDP growth will reach 4.6%, not 6.0% as forecast by the Government.

In the first four months of the year, net Ukrainian enterprise profits dropped by almost 70% compared to the respective period of the previous year. The main declines were registered in real estate transactions and the manufacturing industry. Against the background of an insufficiently developed stock market and banking system, and a low inflow of foreign capital, this deterioration of net profits in the economy undermines the investment ability of enterprises.

Sectoral trends: Ukraine, Russia, and Germany are ready to form a gas transit consortium

Energy sector. Russia's President Vladimir Putin and Ukraine's President Leonid Kuchma signed a protocol aimed at setting up a joint consortium between Russian Gazprom and Ukrainian Naftogaz. The consortium will operate and rebuild the Ukrainian gas transport pipelines. They also signed a protocol with German Federal Chancellor Gerhard Schröder inviting Europe's largest buyers of Russian gas to participate in the consortium. This consortium with European companies should improve the gas supply security, and increase the transparency and reliability of the Ukrainian gas transit system to Europe. To date, the main conflict of interest between potential consortium parties concerns the level of gas transit tariffs. According to Ukrainian legislation, the creation of the consortium must be approved by the Parliament.

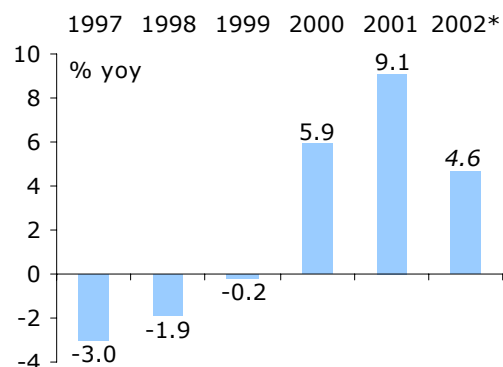
Agriculture. Aiming to prevent the seasonal decline in domestic grain prices during and after each harvest, the Government promised to simplify the grain export regulations. However, the VAT refunding problem remains one of the major obstacles to exports. The State Tax Administration has denied VAT refunds to most grain exporters. Thus, domestic traders consider VAT as an export cost, lowering the purchasing price. The policy inconsistencies between different state bodies prolong the uncertainty and instability on the grain market.

External Sector: Ukraine experiences a regional shift of exports from Russia to Asian markets

As Derzhkomstat reported, the merchandise trade revived in April posting a 3% yoy growth in exports and a 3.7% yoy growth in imports for the first four months of 2002. It seems that the Government has succeeded with its policy efforts to expand the country's exports to Asian markets. Between January and April exports to these countries increased by 35.2%, which partially compensates for the 30.8% loss in exports to Russia.

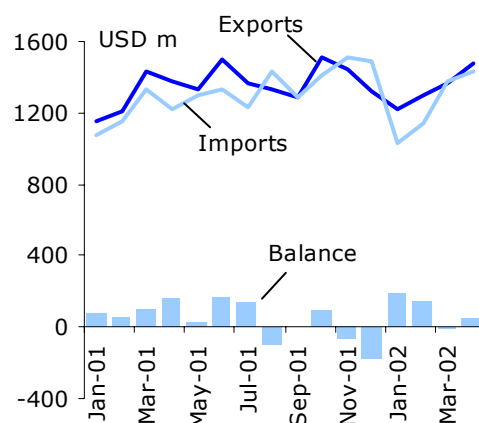
The balance of payments figures, reported by the NBU, revealed a downward tendency for inflows of foreign direct investments (FDI) to Ukraine. During the first quarter of 2002, Ukraine managed to attract only USD 124 m of FDI. This figure is less than that of the first quarters of last two years. A possible explanation is that investment decisions were postponed during the election campaign. However, little optimism exists that FDI inflows will increase during this year since foreign investors continue to stress that substantial structural reform in the economy must come first.

Real GDP Growth



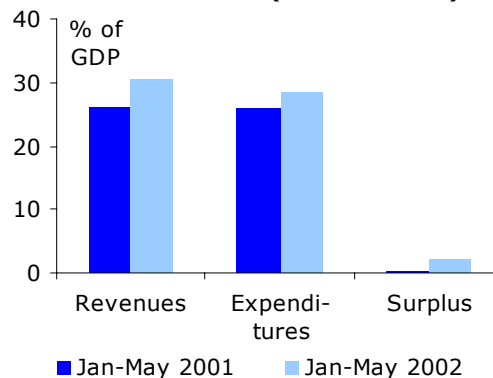
Source: Derzhkomstat
* own forecast

Merchandise Trade Dynamics



Source: Derzhkomstat

Public Finance (Consolidated)



Source: State Treasury

Fiscal policy: A consolidated fiscal surplus was achieved by low state expenditures

From January to May, the Consolidated fiscal surplus made up 2.2% of GDP compared to 0.2% of GDP for the corresponding period of 2001. To a large extent, this surplus is explained by lower than planned expenditures of the central Government. Despite a slowdown in economic activity, the state managed to collect consolidated fiscal revenues at the level of 30.5% of GDP against 26.2% of GDP for January-May 2001. The increase in the share of the GDP redistributed by the state indicates its growing role in the economy.

During January-June the Ministry of Finance received UAH 749 m from selling bonds, i.e. almost a half of the annual 2002 target. Moreover, the first series of 24-month treasury bonds directed at the general population totalling UAH 50 m and issued on May 15 was successfully placed due to a low inflation rate, on-time payments of wages, and financial market stability. However, the future domestic debt development causes some concern because the government failed to sell all government bonds at the last 5 auctions in June. This situation may be due to an increasing uncertainty about the government's ability to fulfil its obligations in 2003, as well as to the lowered bonds' yield to maturity.

Monetary policy: The high interest rate spread persists

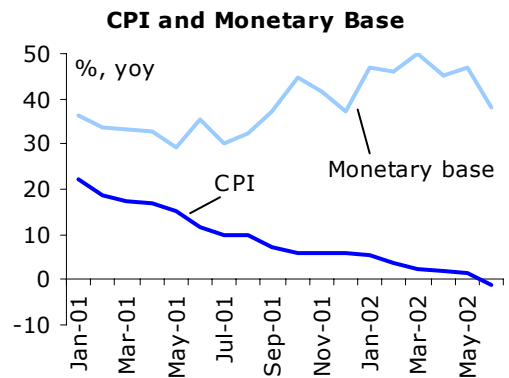
The lending rates of commercial banks reduced by 4.4 percentage points in the first six months of the year. At the same time, deposit rates declined by 2.1 percentage points. As a result, the spread between the lending and deposit rates shrank only slightly to the level of 17%. Among the most important reasons for the persistence of the high spread are the rather high risk level of Ukraine's economy and the necessity to cover for accumulated bad loans.

In June 2002, consumer price inflation became negative for the first time since independence and reached a -1.1% yoy level. The head of the NBU Council, Anatoliy Galchinsky, claims that this year's inflation rate will stay below 6%, while the official forecast is for a 9.8% yoy growth of consumer prices. The monetary base grew by 38% yoy in June 2002 far exceeding inflation, and the official estimations on which the monetary policy for 2002 was based.

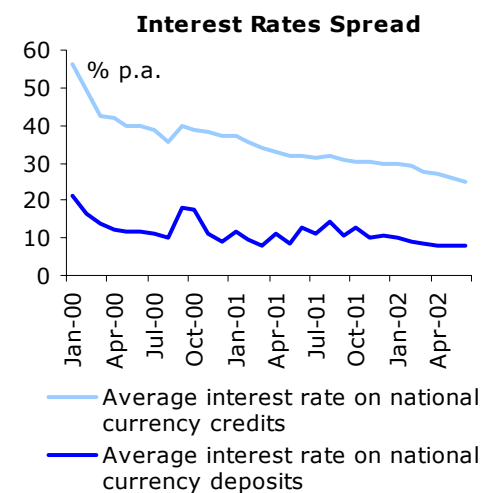
Financial markets: Following world trends, prices for Ukrainian eurobonds went down sharply but recovered quickly

External debt market. Ukrainian eurobonds experienced sharp price fluctuations at the end of June 2002. As of June 21, the price for bonds denominated in euro dropped to EUR 89, or 13% less than the May pick, but later on it recovered, reaching EUR 97.1 on June 28. It is important to stress that the eurobonds price volatility was not caused by any macroeconomic fundamentals of Ukraine, but rather reflects the current situation at other emerging markets on the standing of Ukraine's external obligations. The generally pessimistic expectations towards emerging markets were fuelled by the dramatic drop of the world stock market in the aftermath of negative economic news from the USA and by the decline in Moody's outlook for Brazil from "stable" to "negative". Prices of major Russian stocks became shaky as well.

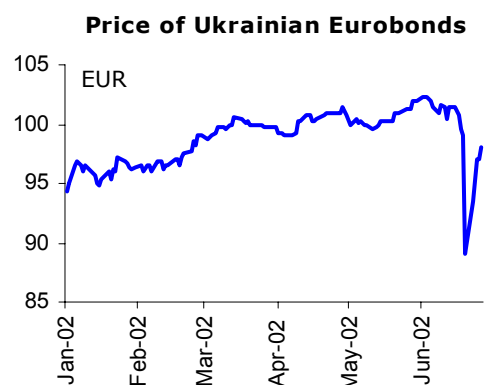
Currency market. Given the quite rigid UAH/USD exchange rate in Ukraine, as well as the euro approaching parity with the US dollar at world foreign exchange markets in June, the hryvnia experienced a significant depreciation vis-à-vis the euro during the month. The rise of the euro's value caused a high demand for euros at the cash market, where the euro exchange rate was at times higher than dollar rate. However, at the inter-bank foreign exchange market trades with US dollars still dominate.



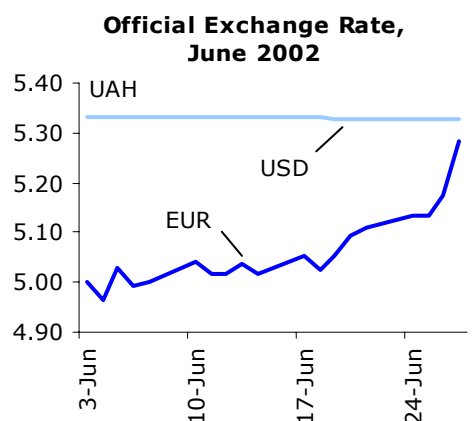
Source: Derzhkomstat, NBU



Source: NBU



Source: Art-Capital



Source: NBU



Economic Trends		Q1 01	Q2 01	Q3 01	Q4 01	Q1 02	Mar	Apr	May	Jun
GDP growth (real)	% yoy	7.8	10.8	10.7	5.7	3.8	4.1	5.0	2.6	...
GDP growth (real)	% yoy cum.	7.8	9.4	10.0	9.1	3.8	3.8	4.1	3.8	...
Industrial production (real)	% yoy cum.	17.4	18.5	16.6	14.2	3.1	3.1	3.5	3.1	...
Agricultural production (real)	% yoy cum.	6.1	5.8	8.6	9.9	11.1	11.1	11.0	10.6	...
CPI	% yoy eop	17.3	11.6	7.3	6.1	2.2	2.2	2.1	1.4	-1.1
PPI	% yoy eop	12.8	9.4	5.9	0.9	-0.5	-0.5	0.5	2.0	4.0
Exports (USD)*	% yoy cum.	15.1	16.0	11.3	9.5	...	1.0"	3.0"
Imports (USD)*	% yoy cum.	3.1	12.3	14.4	14.1	...	-1.2"	3.7"
Merchandise trade balance	USD bn cum	0.16	0.44	0.40	0.20	0.14	0.33"	0.38"
Current account	USD bn cum	0.28	0.85	1.24	1.40	0.72	x	x	x	x
Current account	% GDP	3.5	5.0	4.4	3.7	9.0	x	x	x	x
International reserves	USD bn eop	1.52	1.86	2.72	3.09	3.11	3.11	3.14	3.21	3.41
Monetary Base	% yoy eop	33.1	35.4	37.2	37.4	49.9	49.9	45.2	46.8	38.0
Lending rate on UAH credits **	% pa, eop	33.8	32.1	30.7	29.6	27.7	27.7	27.0	26.2	25.0
Exchange rate (official)	USD aop	5.43	5.41	5.35	5.30	5.32	5.32	5.33	5.33	5.33
Exchange rate (official)	EUR aop	5.02	4.73	4.76	4.74	4.66	4.66	4.71	4.87	5.06

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 ^o	1.2 ^{oo}	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

*** Fiscal balance is calculated in line with new methodology introduced in 2002. "Minus" means budget deficit

^o 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

^{oo} 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