



# Monthly Economic Monitor Ukraine

- In an atmosphere of political crisis, the new head of the NBU was approved by Parliament.
- The FATF decided to recommend to its members to impose counter-measures on Ukraine.
- The introduction of import quotas on grain by the EU induced Ukraine to search for new markets.
- The 2003 Budget was approved in December with a UAH 2 bn deficit.
- The Government issued UAH 1.3 bn of long-term domestic state bonds with a current yield of 9%.
- The Ministry of Finance set a negative interest rate on POVDPs, mainly held by the NBU.
- The NBU reduced the discount rate from 8% to 7%.

**No.1 (27)  
January  
2003**

**Population: 48.4 m**  
**Industry/GDP: 30.9%**  
**Agriculture/GDP: 14.7%**  
**Investment/GDP: 20.4%**  
**Export destinations: Russia 22%, EU 17%**  
**Import origins: Russia 34%, EU 20%**

## Politics: A new head of the NBU was approved

In December Parliament was in a political crisis. In an attempt to block the decision to change the head of the NBU, opposition factions physically impeded the work of the Verkhovna Rada throughout most of the parliamentary session. It became impossible to vote using the electronic system, hence the pro-presidential factions voted by signature to execute all further votes using paper ballots. On December 17, the following decisions were adopted using this procedure: Volodymyr Stelmakh was dismissed from the position of head of the NBU and Sergiy Tihipko was appointed his successor; the parliamentary committee leadership was redistributed in favour of pro-presidential factions in 20 committees; the 2003 budget approval was reversed in second reading.

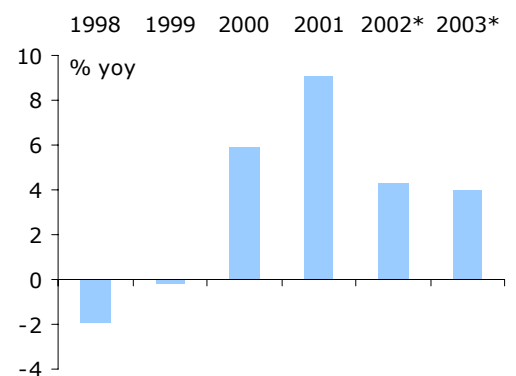
The opposition questioned the legality of these decisions, since the majority leaders failed to prove the transparency of the voting and counting procedures. To unblock the parliamentary stalemate the decision to strip the opposition from parliamentary committees was cancelled by a vote on December 24, which allowed the 2003 budget to pass in second and third readings during the last week of December.

On December 20, 2002 the Financial Action Task Force on Money Laundering (FATF) approved a decision to recommend to its members to impose counter-measures on Ukraine, in reaction to Ukraine's failure to enact anti-money laundering legislation that would meet international standards. Ukrainian legislation, approved on December 7 under the threat of these FATF sanctions, failed to correct the major deficiencies pointed out by the FATF. The US Ministry of Finance immediately announced that the USA was going to use special measures, that may include the reporting and registration of beneficial and nominal owners of accounts held by Ukrainian residents in US banks in cases where amounts exceeding USD 50,000 were transmitted from the USA to Ukraine or vice-versa. In an attempt to persuade the FATF to revise its decision during its February plenary meeting, Parliament introduced some further amendments to the legislation. The most serious explicit measure threatening Ukraine is blocking the correspondent accounts of Ukrainian banks in member countries of the FATF. Taking into account the high degree of trade openness of Ukraine, this can be quite painful for Ukrainian economic agents dealing within international markets.

## Real economy: The real GDP growth stabilized at the 4.1% level

During the first eleven months of 2002 the real GDP growth was at 4.1% yoy. As before, the major value added contributions came from

**Real GDP Growth**



Source: Derzhkomstat  
 \* official forecast, conservative scenario

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the wholesale and retail trades, manufacturing, and agriculture. The Ministry of Economy and European Integration further reduced its estimates of the real GDP figures for 2002. The current estimate is a 4.2-4.5% growth.

From January to September investments in fixed capital increased by 6.2% yoy, compared to a 25.5% growth in the respective period of 2001. As before, approximately two thirds of all investments were financed with the enterprises' own funds, while bank credits constituted only 5% of the total volume. Lower net profits compared to the previous year, as well as political uncertainty in the country, are likely to be among the major reasons for the decreased investment activity.

**Sectoral trends: Ukraine promotes grain exports to new markets**

**Agriculture.** The Ukrainian Government actively promoted grain exports to new existing foreign markets. In particular, Malaysia and Indonesia bought Ukrainian grain in 2002 for the first time, and grain exports to North Africa and to Brazil are growing. The government effort is largely caused by restricted access to Ukraine's traditional export markets in the EU, due to a new import quota imposed by the EU Commission for 2003. Since an individual quota was not given to Ukraine, it has to compete with other grain suppliers. In spite of that, Ukraine has good export prospects due to the competitiveness of Ukraine's grain on the world market.

**Energy.** Ukraine's Naftogaz and Russia's Gazprom signed a number of cooperation agreements in 2003. According to these agreements, Russia guarantees to transit 110 bn m<sup>3</sup> of natural gas to Europe through Ukraine under in-kind payment conditions. If the transit exceeds the agreed-to amount, payment for the additionally transited volumes will be in monetary form. The companies also agreed that Gazprom will transit Turkmenian gas through Russian territory to Ukraine. These agreements seem to be beneficial to Naftogaz, since in 2003 payments for the transit service will amount to 38% of the natural gas transit compared to about 41% levied in 2001-2002 by Itera, the previous gas transit operator.

Ukraine, Russia, Belarus, Slovakia, Hungary and Croatia signed a treaty on a single tariff of USD 0.64 per ton/100 km for crude oil transport. This agreement allows the Druzhba-Adria pipeline from the Russian city of Samara to the Croatian deep-sea terminal in Omishal to start operating. The implementation of this project is a substantial step towards realizing Ukraine's long-range strategy to become an energy bridge to Europe.

**External Sector: Current account balance expands**

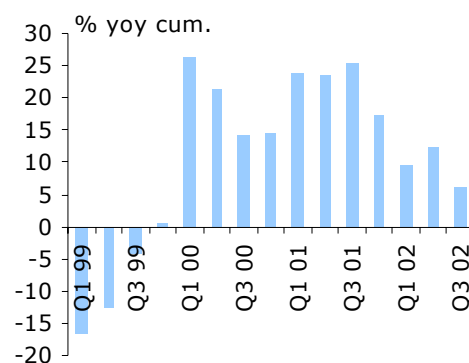
The cumulative balance of current account for the first nine months of the year was USD 2.1 bn, almost 50% higher than for the respective period of 2001, due to growth of the merchandise trade balance and current transfers. The NBU estimates that the annual current account balance for 2002 will reach at least USD 2.3 bn, while in 2003 it will fall back to USD 1.7 bn due to import intensification. According to Derzhkomstat, exports grew by 7.3% yoy in the first ten months of 2002 and imports by 6.7% yoy. Export accelerations were observed mainly in metal products, grain, and petroleum processing products.

**Fiscal policy: Budget 2003 was approved in one week**

The Government developed a new 2003 budget draft based on revised macroeconomic and budget indicators replacing an earlier version of the budget passed in second reading in November. On December 26, the budget was approved by the Verkhovna Rada with total revenues of UAH 50 bn and UAH 52 bn of expenditures.

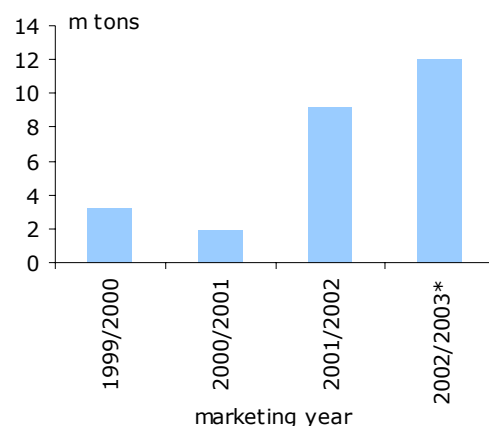
The tax revenues envisaged in the 2003 budget may be seen as being quite realistic. The recent approval of amendments to major

**Investment in Fixed Capital**



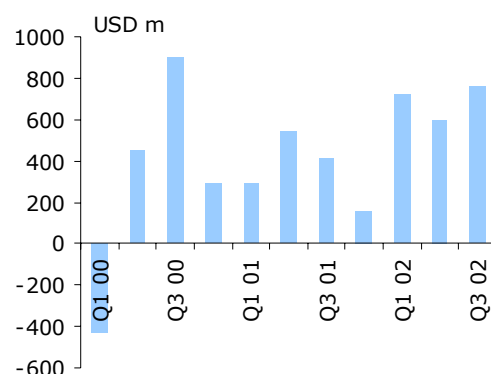
Source: Derzhkomstat

**Ukrainian Grain Export**



Sources: Derzhkomstat, Ministry of Agricultural Policy of Ukraine  
\* Ministry of Agricultural Policy of Ukraine forecast

**Dynamics of Current Account**



Source: NBU

tax laws should allow raising additional funds. Risks for revenue shortfalls are associated with non-tax revenues, such as partial transfers of profits from state enterprises, the collections of dividends from state property, and the natural gas transit fee. In line with international standards, privatisation receipts in the amount of UAH 2.2 bn are included as deficit-financing items.

In December the Government started issuing long-term government bonds (DGOs) with a maturity of more than 5 years. In 2001-02 only short- and medium-term securities were placed. In December the Government attracted about UAH 1.3 bn of the planned UAH 2.8 bn through selling DGOs at the rather low weighted average current yield of 9%. Oschadbank, the state owned bank, is said to have been the main buyer of the DGOs. At the same time, the placement was possible due to availability of free funds in the banking sector and a lack of alternative ways to invest them. In addition to the internal borrowings, about USD 120 m were attracted from external capital markets through the placing of Eurobonds 2000 at the current yield of 10.4%.

**Monetary policy: The POVDP interest rate is set at a negative level**

The Ministry of Finance set the interest rate on interest-bearing domestic government bonds (POVDPs) for 2003 at the level of minus 0.65% per annum. POVDPs were issued in 2000 as a result of an arrangement between the Government and the NBU on restructuring treasury bills in the NBU portfolio. Currently the NBU holds almost all POVDPs with a total nominal value of nearly UAH 8 bn. As explained by the Ministry of Finance, the negative figure resulted from the large discrepancy between the official inflation forecast for 2002 (9.8% yoy) and the actual level of inflation in November 2002 (-0.4% yoy), both used in the interest rate calculation. The negative value of the nominal interest rate creates a paradoxical situation, where the lender (the NBU) will have to pay to the borrower (the government). Interest payments amount to about UAH 52 m; but taking next year's anticipated inflation into account, the real cost to the NBU could be much higher. NBU officials said that the NBU would not make any interest payments to the Government.

In December the NBU reduced its discount rate from 8% to 7% per annum. However, this measure is not likely to have a loosening effect on monetary conditions, since the discount rate is the least effective instrument of monetary policy in Ukraine. Rather, after stalling at a very low level for several months, the interbank interest rate has started to increase steadily in December, indicating a reduction of liquidity in the banking system.

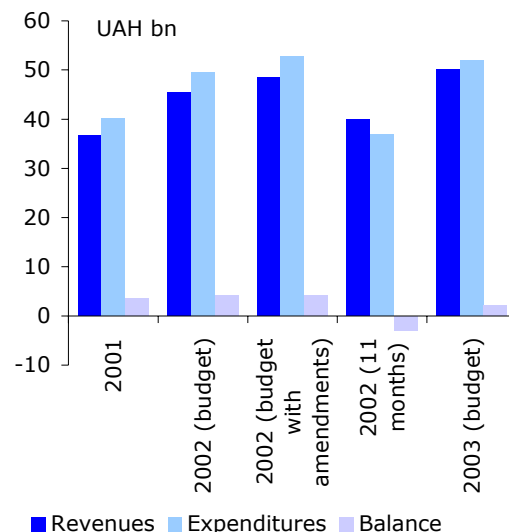
In 2002 the monetary base grew by 33.6% yoy, quite close to the revised NBU forecast. The CPI inflation reached -0.6% yoy, whereas producer prices grew by 5.7% yoy. For 2003 CPI inflation is forecasted at 5.2% according to the conservative scenario of the Ministry of Economy.

**Financial markets: The NBU loosened several procedures of bank supervision**

**Banking sector.** The NBU loosened several procedures of its bank supervision. Starting in 2003, commercial banks will have to submit extended accounting reports quarterly rather than monthly balance sheets. This new system is expected to be more accurate and complete: the quarterly reports will also include report on off-balance obligations, as well as data on the financial results.

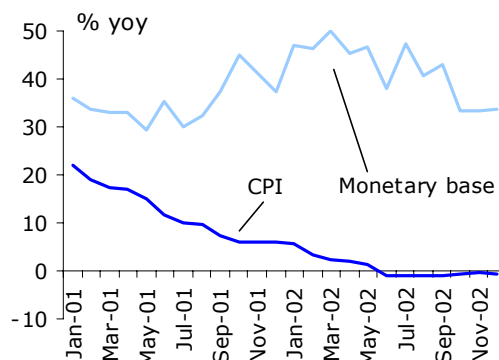
In order to avoid difficulties by Ukrainian banks in case the FATF sanctions are applied, the NBU allowed commercial banks to open hard-currency correspondent accounts at CIS banks and offshore. Although such a measure would soften consequences of the FATF sanctions, the costs of transferring correspondent accounts to other banks will still be high and the efficiency of transactions will be lower.

**Central Fiscal Performance\***



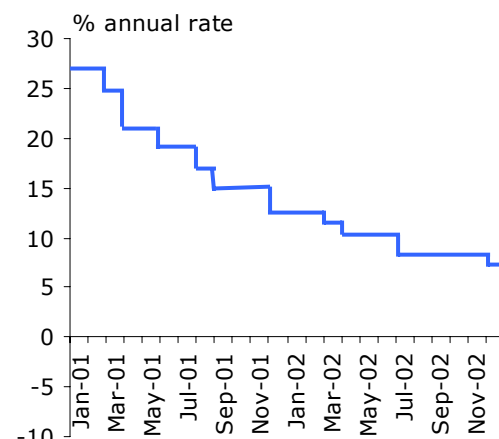
Source: State Treasury  
\*privatization receipts as a deficit-financing item,  
(-) means surplus

**CPI and Monetary Base Development**



Source: Derzhkomstat, NBU

**Discount Rate Dynamics**



Source: NBU



<b>Economic Trends</b>		<b>Q3 01</b>	<b>Q4 01</b>	<b>Q1 02</b>	<b>Q2 02</b>	<b>Q3 02</b>	<b>Sep</b>	<b>Oct</b>	<b>Nov</b>	<b>Dec</b>
GDP growth (real)	% yoy	10.7	5.7	4.1	4.5	3.5	3.1	3.8	4.6	...
GDP growth (real)	% yoy cum.	10.0	9.1	4.1	4.3	4.1	4.1	4.1	4.1	...
Industrial production (real)	% yoy cum.	16.6	14.2	3.1	5.8	6.0	6.0	6.0	6.3	...
Agricultural production (real)	% yoy cum.	8.6	9.9	11.1	9.2	3.0	3.0	2.9	2.7	...
CPI	% yoy eop	7.3	6.1	2.2	-1.1	-1.1	-1.1	-0.6	-0.4	-0.6
PPI	% yoy eop	5.9	0.9	-0.5	4.0	4.9	4.9	5.8	5.3	5.7
Exports (USD)*	% yoy cum.	11.3	9.5	1.5	2.4	...	6.3"	7.3"	...	...
Imports (USD)*	% yoy cum.	14.4	14.1	-2.1	0.9	...	6.0"	6.7"	...	...
Merchandise trade balance	USD bn cum.	0.40	0.20	0.14	0.20	0.37	0.71"	0.86"	...	...
Current account	USD bn cum.	1.24	1.40	0.72	1.32	2.09	x	x	x	x
Current account	% GDP	4.4	3.7	9.0	7.5	7.2	x	x	x	x
International reserves	USD bn eop	2.72	3.09	3.11	3.41	4.02	4.02	4.10	4.32	4.42
Monetary Base	% yoy eop	37.2	37.4	49.9	38.0	42.9	42.9	33.2	33.2	33.6
Lending rate on UAH credits **	% pa, eop	30.7	29.6	27.7	25.0	20.1	20.1	19.4	19.4	19.5
Exchange rate (official)	USD aop	5.35	5.30	5.32	5.33	5.33	5.33	5.33	5.33	5.33
Exchange rate (official)	EUR aop	4.76	4.74	4.66	4.88	5.24	5.23	5.23	5.34	5.42

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)

<b>Key Economic Indicators</b>		<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>
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 <sup>o</sup>	1.2 <sup>oo</sup>	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

\*\*\* The fiscal balance is calculated in line with the new methodology introduced in 2002.

"Minus" denotes a budget deficit

<sup>o</sup> 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

<sup>oo</sup> The value of the aircraft complexes transferred to Russia as repayment of a gas debts according to the inter-governmental agreement reached in October 1999 totaling USD 274 m is not included.

#### Notes:

<b>avg</b>	average	<b>ytd</b>	year-to-date
<b>cum.</b>	cumulative	<b>p.a.</b>	per annum
<b>mom</b>	month on month change	<b>eop</b>	end of the period
<b>qoq</b>	quarter on quarter change	<b>aop</b>	average of the period
<b>yoy</b>	year on year change	<b>gs</b>	goods and services