

Monthly Economic Monitor Ukraine

- Several FATF member-countries announced the application of counter-measures to Ukraine.
- During the informal summit of CIS leaders, President Leonid Kuchma of Ukraine was elected Head of the Council of the CIS.
- According to preliminary estimates, the real GDP grew by 4.1% in 2002 due to increases in manufacturing and trade.
- The government introduced price regulation on milk and meat products aimed at supporting farmers' profits.
- Despite a fiscal surplus, the consolidated fiscal expenditures remained under-executed in 2002.
- The NBU adopted measures to soften foreign exchange market regulations.

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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: FATF members applied counter-measures to Ukraine

Following FATF recommendations, the USA, Canada, the United Kingdom, Germany, Sweden, Finland and Turkey announced that they will apply counter-measures to Ukraine: banks in those countries now request that Ukrainian banks provide additional information concerning the nature of all transactions. This information is reported to the financial intelligence institutions of the respective countries. As a result, the timing and cost of money transfers has increased. The Ukrainian Government has tried to improve the legislation of some key aspects raised by the FATF: to lower the limit for checking transactions to EUR 15,000, to secure political independence of the Department of Financial Monitoring, and to introduce criminal penalties for money laundering. Whether such efforts are successful will become clear during the next FATF meeting on February 12.

An informal meeting of the leaders of the Commonwealth of Independent States (CIS) was held in Kyiv on January 28-29. The summit was attended by 9 leaders of the CIS countries, while Asian members sent lower rank representatives. Although Ukraine is not a full member of the CIS, Leonid Kuchma, the President of Ukraine, was elected during the meeting to be the Head of the Council of the CIS, previously headed by the President of Russia.

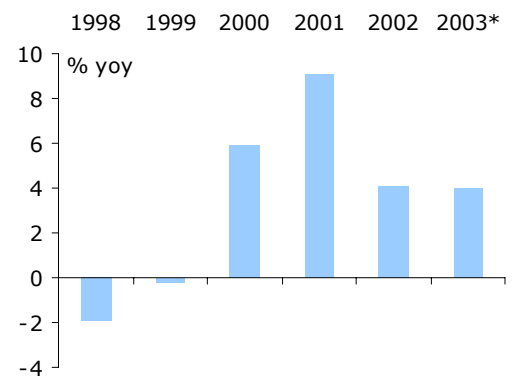
Mr. Kuchma and the Russian president Vladimir Putin signed 10 bilateral treaties during the meeting. The treaty subjects included state borders, education and health care. However, long-awaited decisions on trade and other economic issues were postponed till September.

Ukraine was censured for inadequate performance in the area of freedom of speech by the Parliamentary Assembly of the Council of Europe, which adopted a recommendation on freedom of expression in the media of Europe on January 28. Ukraine is listed among the countries, where violence against journalists, disproportionately high fines, defamation suits, and other forms of economic pressure on the media exist. The recommendation also mentioned, that "according to numerous journalists and the conclusions of parliamentary hearings on the freedom of speech and on censorship, the presidential administration provides instructions to the media on the coverage of major political events".

Real economy: The real GDP grew by 4.1% in 2002

According to preliminary estimates by Derzhkomstat, the real GDP grew by 4.1% yoy in 2002 mainly due to growing value added in manufacturing and in the wholesale and retail trades. Industrial output increased by 7.0% in real terms compared to a 14.2% yoy expansion in 2001. As before, major contributors to growth were the

Real GDP Growth



Source: Derzhkomstat
 * official forecast, conservative scenario

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food and petroleum-refining industries, also metallurgy and machine building. Altogether these industries accounted for two thirds of the annual industrial growth. Slowdown of agricultural production that grew by 1.9% in 2002, as compared to a 10.2% rise in the year 2001 was due to a significant deceleration of plant production, while animal husbandry continued to develop steadily.

An analysis of the expenditure side of the GDP demonstrated that during the first nine months of 2002 final consumption remained a dominant source of aggregate demand in Ukraine. After a yearlong pause, external demand once again became an important growth engine since the growth rates of exports of goods and services in real terms were twice as high as the import ones. On the other hand, fixed capital growth remained quite moderate, raising questions about the stability and high rates of Ukraine's future economic development.

Sectoral trends: The Government introduced price regulations for milk and meat

Agriculture. At the end of 2002, the Government established a network of regional committees regulating livestock product markets. The main task of the committees is to regulate prices for animal husbandry products in order to ensure the profitability of all market participants, including farms. In January several regional committees introduced minimal meat and milk purchase prices. Such a policy substitutes market forces with state regulation and moves the reform process in the Ukrainian agricultural sector a step back. Moreover, such a policy will increase milk and meat product prices, which are already quite high for many Ukrainians. Taking into account that Russia had introduced an import quota on meat products, the total demand for meat may drop significantly in Ukraine, depressing its production.

Energy sector. The government started a reorganisation of the coal industry. More than 200 coal enterprises will be transformed into 21 joint stock companies for further privatisation. Currently coalmines can act as independent legal entities. The proposed reorganization will result in cross-subsidisation of less efficient coalmines by more efficient ones. The great majority of the existing coalmines are severe loss-makers, thus the demand for newly established joint stock companies will crucially depend on future state support to the industry. However, continuation of state intervention in this sector will prevent it from becoming efficient and will undermine the whole idea of privatisation.

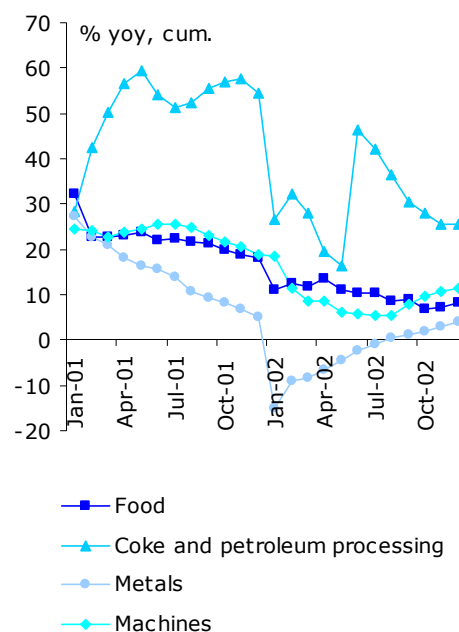
The Cabinet of Ministers adopted a decree on ceiling prices for natural gas for industrial consumers to limit the monopoly power of Naftogaz. This company now has practically 100% control over the wholesale market after Itera had left the Ukrainian market this year.

Infrastructure. Daewoo Corporation (South Korea) has sold 49% of the shares in the closed joint stock company "Ukrainian radiosystems", a mobile phone operator working under the WellCOM trademark. This is likely to resolve the three-year conflict between Korean and Ukrainian shareholders concerning the company's management, and might stimulate new investment in the company. Since WellCOM owns licenses for mobile communication services in all regions of Ukraine, it is likely to become the third largest mobile phone operator in Ukraine enhancing competition in the industry.

External sector: The merchandise trade surplus reached USD 1 bn

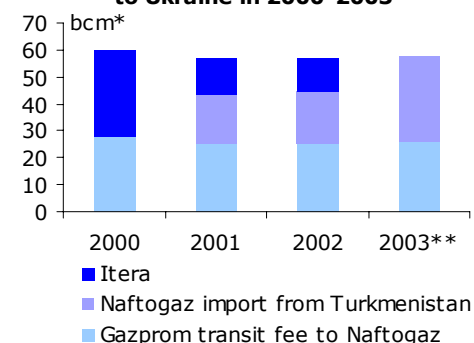
According to Derzhkomstat, exports of goods increased by 7.9% yoy in dollar terms between January and November, while imports grew only by 5.9% yoy. This trend resulted in a 57% yoy increase in the trade surplus now totalling USD 1.04 bn. Major contributors to the export growth were grain and mineral products, as well as metals. On the import side, growth was represented by increases in such categories as transport, chemicals and raw mineral products.

Growth of Output in Selected Industries



Source: Derzhkomstat

Structure of Natural Gas Import to Ukraine in 2000-2003

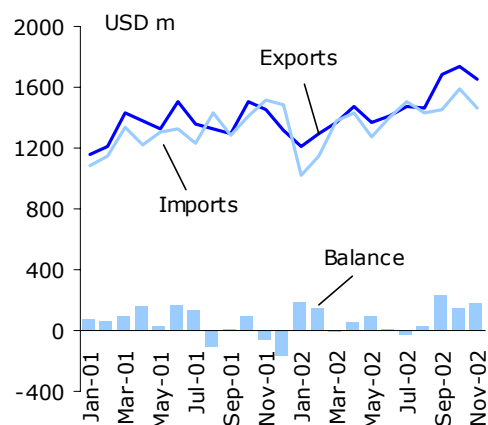


* billion cubic meters

**Cabinet of Ministers forecast

Source: Cabinet of Ministers, Ministry of Economy, Energobusiness

Merchandise Trade Dynamics



Source: Derzhkomstat

Fiscal policy: Despite a fiscal surplus, expenditures remained below budgeted levels in 2002

According to preliminary data, the 2002 consolidated fiscal surplus amounts to UAH 1.7 bn, compared to the planned deficit of UAH 4.2 bn. The revenue execution was 94%, while the expenditure execution amounted to 86%. Poor collection of the central fiscal revenues was partially compensated by good local fiscal performance. Major shortfalls occurred in enterprise profit tax revenues, dividends of state-owned enterprises, the natural gas transit fee, as well as in privatisation. The major non-executed expenditure item was financing of economic activities, including capital investments. Because targets for current expenditures had a priority over capital expenditures, the role of the state in investments remained limited. This shifts investment activity, which is responsible for future economic growth, to the private sector.

Monetary policy: The CPI grew 1.5% in January

Following traditional seasonal dynamics in January, the monetary base decreased by 3% mom, while consumer prices grew by 1.5% mom, still staying 0.1% lower than at the same period last year. The increase in prices was, to a large extent, caused by a temporary expansion of consumer demand. Social payments, usually made in December, as well as pre-holiday bonuses were the main contributors to consumer demand growth.

Due to purchases of long-term governments bonds and increases in crediting at the end of last year, the banking system entered 2003 with reduced excess liquidity. As a result, after a half-year interruption the demand for NBU discount loans resumed in January. The subsequent reduction of the interbank interest rate indicates that bank liquidity was restored.

Financial markets: The NBU slightly loosened foreign exchange market regulations

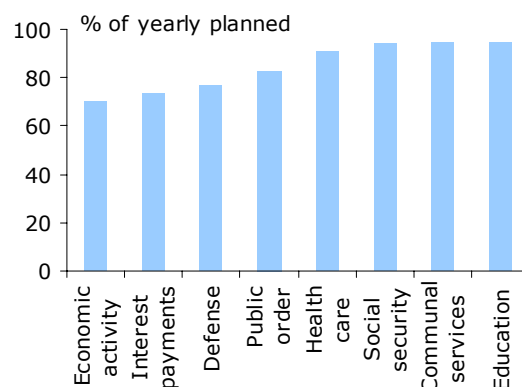
Foreign exchange market. In January several measures loosening the foreign exchange market regulations were adopted by the NBU. Among others, the NBU permitted forward operations with hard currency on international foreign exchange markets. Although the changes in the regulations are minor, they might be treated as the first step towards the long-awaited liberalisation of the foreign exchange market. However, the softening of the most restrictive regulation – the 50% obligatory sale of foreign exchange receipts – remains an unresolved question.

According to the Law on Budget 2003, cash operations with foreign currency are exempted from the 1% Pension Fund duty, introduced in 1998. The overall effect of the exemption seems to be beneficial, since higher profits in the banking sector and the reduction of the volumes of shadow operations with foreign currency should outweigh any losses to the Pension Fund.

Banking sector. The Ukrainian banking sector kept growing fast in 2002. Credits to the economy grew by 45% yoy, while deposits grew by 70% yoy. Aggregate profits of the commercial banks amounted to UAH 750 m, a 40% increase compared to 2001. Although the capital of commercial banks grew by 30%, 12 banks failed to meet the requirements of the NBU concerning capital adequacy and will be either transformed to cooperative banks or acquired by larger banks.

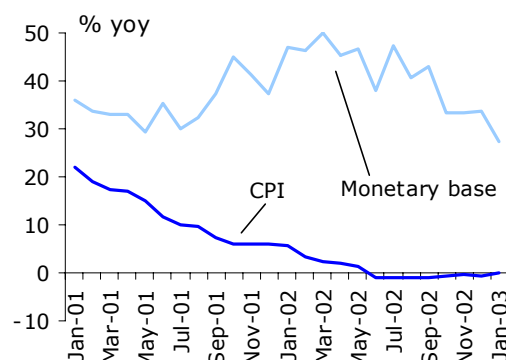
Notwithstanding progress in the banking system, the NBU stated that it is too early to open the domestic financial market to foreign competitors. The new Head of the NBU, Serhiy Tihipko, called back from Parliament a draft law that envisaged permission to foreign banks to open branches in Ukraine. This measure will protect the Ukrainian banking system from tougher competition for some time, but does not release it from the necessity to move towards international standards.

Execution of Consolidated Fiscal Expenditures



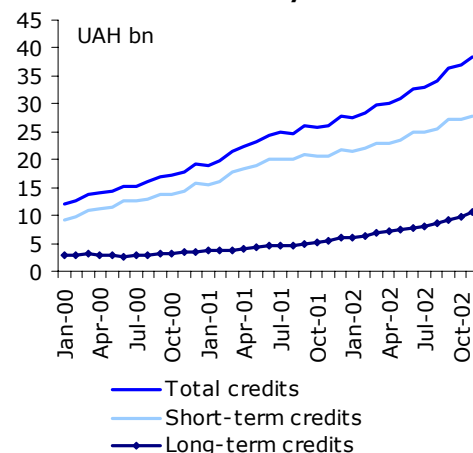
Source: State Treasury

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

Credits of Commercial Banks to Economy



Source: NBU



Economic Trends		Q4 01	Q1 02	Q2 02	Q3 02	Q4 02	Oct	Nov	Dec	Jan
GDP growth (real)	% yoy	5.7	4.1	4.5	3.5	...	3.8	4.6
GDP growth (real)	% yoy cum.	9.1	4.1	4.3	4.1	4.1	4.1	4.1	4.1	...
Industrial production (real)	% yoy cum.	14.2	3.1	5.8	6.0	7.0	6.0	6.3	7.0	...
Agricultural production (real)	% yoy cum.	9.9	11.1	9.2	3.0	1.9	2.9	2.7	1.9	...
CPI	% yoy eop	6.1	2.2	-1.1	-1.1	-0.6	-0.6	-0.4	-0.6	-0.1
PPI	% yoy eop	0.9	-0.5	4.0	4.9	5.7	5.8	5.3	5.7	6.8
Exports (USD)*	% yoy cum.	9.5	1.5	2.4	6.9	...	7.3"	7.9"
Imports (USD)*	% yoy cum.	14.1	-2.1	0.9	4.7	...	6.7"	5.8"
Merchandise trade balance	USD bn cum.	0.20	0.14	0.20	0.37	...	0.86"	1.04"
Current account	USD bn cum.	1.40	0.72	1.32	2.09	...	x	x	x	x
Current account	% GDP	3.7	9.0	7.5	7.2	...	x	x	x	x
International reserves	USD bn eop	3.09	3.11	3.41	4.02	4.42	4.10	4.32	4.42	4.56
Monetary Base	% yoy eop	37.4	49.9	38.0	42.9	33.6	33.2	33.2	33.6	27.2
Lending rate on UAH credits **	% pa, eop	29.6	27.7	25.0	20.1	19.5	19.4	19.4	19.5	18.6
Exchange rate (official)	USD aop	5.30	5.32	5.33	5.33	5.33	5.33	5.33	5.33	5.33
Exchange rate (official)	EUR aop	4.74	4.66	4.88	5.24	5.33	5.23	5.34	5.42	5.68

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	2002
Nominal GDP	UAH bn	54.5	81.5	93.4	102.6	130.4	173.0	204.2	...
Nominal GDP	USD bn	37.0	44.6	50.2	41.9	31.6	31.8	37.8	...
GDP growth (real)	% yoy	-12.2	-10.0	-3.0	-1.9	-0.2	5.9	9.2	4.1
Industrial production	% yoy	-12.0	-5.1	-0.3	-1.0	4.0	12.4	14.2	7.0
Agricultural production	% yoy	-3.6	-9.5	-1.9	-9.8	-6.9	9.8	9.9	1.9
CPI	% yoy aop	376.4	80.2	15.9	10.6	22.7	28.2	12.0	0.8
CPI	% yoy eop	181.7	39.7	10.1	20.0	19.2	25.8	6.1	-0.6
PPI	% yoy aop	488.9	52.1	7.7	13.2	31.5	20.9	8.6	3.1
PPI	% yoy eop	172.1	17.3	5.0	35.4	16.0	20.8	0.9	5.7
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	4.4
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	33.6
Exchange rate	USD aop	1.5	1.8	1.9	2.4	4.1	5.4	5.4	5.3
Exchange rate	USD eop	1.8	1.9	1.9	3.4	5.1	5.4	5.3	5.3
Exchange rate	EUR aop	1.9	2.3	2.1	2.8	4.4	5.0	4.8	5.0
Exchange rate	EUR eop	2.3	2.4	2.1	4.0	5.2	5.1	4.7	5.5

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

^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 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:

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