

Monthly Economic Monitor Ukraine

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- The FATF recommended to abolish counter-measures against Ukraine, but did not remove Ukraine from its blacklist.
- Ukraine, Russia, Belarus, and Kazakhstan plan to establish a Common Economic Area.
- The management of all state corporate rights was transferred to the State Property Fund.
- Ukraine and Hungary signed an agreement on goods and service markets access within the framework of WTO accession.
- The Cabinet of Ministers introduced new procedures concerning local fiscal borrowing.
- The NBU made refinancing loans more attractive for banks.
- Ukrainian commercial banks were given the right to trade in Ukrainian Eurobonds.

Politics: The FATF recommended to lift counter-measures against Ukraine

The Financial Action Task Force (FATF) was satisfied with Ukraine's progress with strengthening the fight against money laundering, and recommended that its member-countries lift their counter-measures. This decision was made during the February meeting of the FATF in Paris. However, Ukraine will remain on the blacklist of all non-cooperating countries at least until the next meeting of the FATF in June 2003. In the meantime Ukraine has to submit reports to the FATF on the implementation of its anti-money laundering legislation, while a delegation of the FATF will come to Kyiv to assess the efficiency of the Department for Financial Monitoring. Deputy Prime Minister Mykola Azarov announced that it is more realistic to expect Ukraine's removal from the blacklist by the end of 2003.

On February 23 the Presidents of Ukraine, Russia, Belarus and Kazakhstan decided to prepare an agreement on a Common Economic Area by September 2003. Kyiv City was chosen to host the working group on developing the agreement, headed by a high-ranking Kazakhstan official. The main goal of the Common Economic Area will be to establish a free trade zone between the four countries. To remove trade barriers has always been one of the goals of the Commonwealth of Independent States (CIS), and initiatives of this kind have regularly been put forward since its inception. However none has ever reached the implementation stage.

President of Ukraine Leonid Kuchma stated that Ukraine would support any decision of the UN concerning Iraq. In case of military action in the region, Ukraine is prepared to provide to the UN a battalion for chemical, bacteriological and radioactive defence. As was reported earlier, Ukraine faces allegations to have supplied military equipment to Iraq. The USA and Ukraine still have not resolved the questions surrounding the alleged supply of Ukrainian "Kolchuga" radars to Iraq.

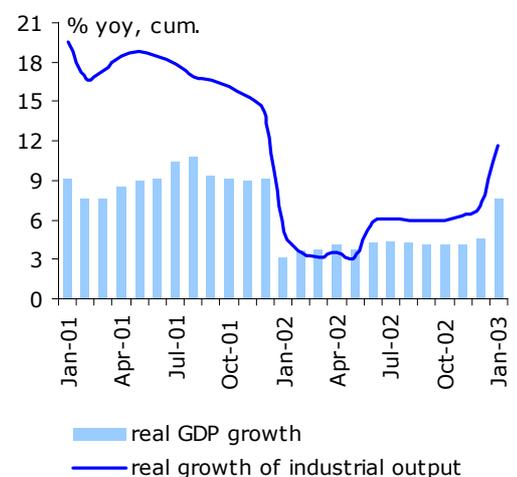
Real economy: Real GDP growth accelerated in January

In January 2003 real the GDP growth accelerated to 7.7% yoy. Major value added growth occurred in the manufacturing industry (13.8% yoy) and construction (24.4% yoy), while the retail and wholesale trades achieved a modest 8.8% yoy level of growth, maintaining the decelerating tendency observed during the previous year. Industrial output increased by 11.6% yoy, with all three branches – extractive industry, manufacturing industry, and production and distribution of electricity, water, and gas – growing. The highest 22% yoy growth was registered in metallurgy, responding to favourable conditions on the world metal markets.

The first month of the year was marked by a 21.6% yoy growth in construction after a yearlong pause in the sector's development

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%

GDP and Industrial Output



Source: Derzhkomstat

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caused largely by political uncertainty. The volume of signed annual contracts increased by one fifth in nominal terms when compared with the respective period of the previous year. Since construction output constitutes approximately 40% of all investments, the latter are expected to accelerate in the year 2003.

Sectoral trends: All state corporate rights were transferred to the State Property Fund

Privatisation. In line with the President’s request to concentrate the management of state corporate rights in the State Property Fund (SPF) exclusively, the Cabinet of Ministers has transferred all state ownership shares to the SPF. This transfer should allow property management to become more efficient by putting the state corporate rights in order. However, the SPF is technically incapable of managing all these corporate ownerships on its own. Thus, the SPF should either be expanded or a separate agency should be created for managing state assets. To tackle this problem, the SPF plans to outsource some of the state corporate management effort to the central authorities. Specifically, this concerns the state-owned oil and gas company “Naftogaz Ukrayiny”. However, the transfer of state property management rights to the SPF and then back to the central executive authorities could muddle the whole redistribution of state ownership control issue.

Infrastructure. The Parliament of Ukraine has overruled the presidential veto of the law abolishing payments for incoming calls. The law comes in force in six months. Then any provider of telephone communication services will be prohibited from charging for incoming calls. It is likely that the decision will cause significant subscriber fee increases for mobile telephone services, the cancellation of all direct mobile numbers, and an increase in the charges for outgoing calls for fixed-line consumers. Taking into account the underdeveloped state of regulations on interconnection and of intra-industry payments, this measure seems to be premature.

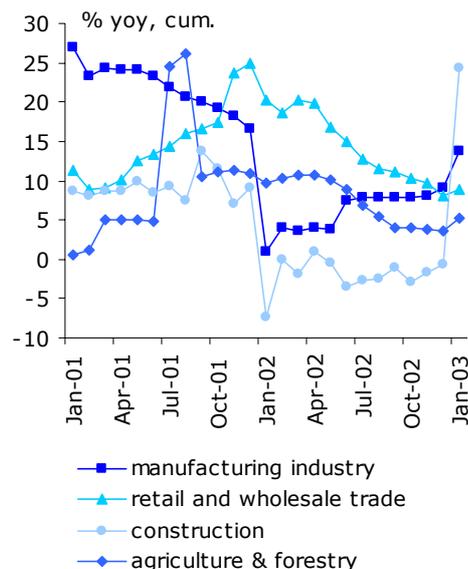
Agriculture. Following a presidential decree, the State Committee on Land Resources was made the only institution to maintain land cadastre data and register real estate property rights. The committee records land plots, real estate, and property rights on them; keeps the State Register of Land and Real Estate Property Rights; and it serves as the land-use organization. It is expected that centralizing all real estate records will improve property rights protection and promote development of a mortgage market in Ukraine.

External sector: Ukraine is gradually progressing towards WTO accession

During a February meeting of the Working Party on Ukraine’s WTO accession, Hungary and Ukraine signed an agreement on access to goods and service markets. This is the tenth such agreement signed by Ukraine during the ten years of the accession process. As announced, participants of the meeting supported a proposal to start working on the Protocol of Accession, the document that finalises country accession procedures. However, harmonizing the national legislation with WTO requirements remains one of the key prerequisites for further progress in negotiations.

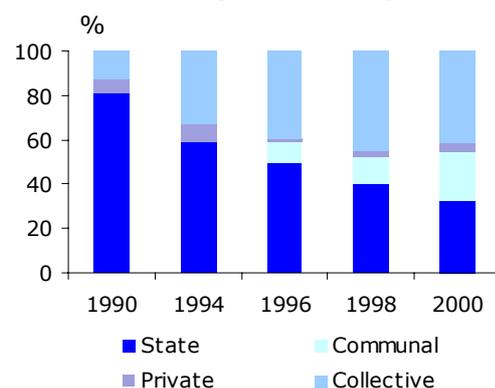
According to Derzhkomstat, exports of goods grew by 10.4% in dollar terms in 2002, while imports increased by 7.6%. A 6.4% yoy drop of exports to the CIS countries, mainly due to a significant trade reduction with Russia, was compensated by a 17% yoy rise of exports to the rest of the world, in particular to Asia (27.6% yoy) and Europe (13.8% yoy). Growing regional diversity of exports partially counter-weights the risk of concentrated products structure of Ukraine’s exports. As before, almost 40% of total exports are ferrous metals, which are always strongly influenced by world market fluctuations and vulnerable to protectionist measures.

Growth of Value Added in Selected Sectors



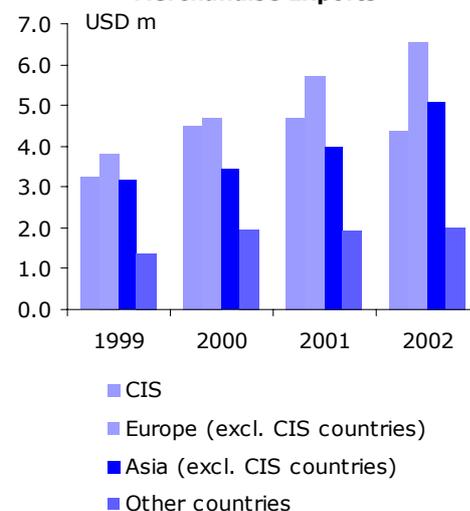
Source: Derzhkomstat

Fixed Capital Ownership



Source: Derzhkomstat

Regional Distribution of Merchandise Exports



Source: Derzhkomstat

Fiscal policy: A special procedure for local fiscal borrowings was introduced

In line with the Budget Code, the Cabinet of Ministers approved a new procedure for local government borrowings. The local authorities have to coordinate their planned borrowings or debt restructurings with the Ministry of Finance and satisfy a number of requirements. The Ministry can veto municipal borrowings plans, if it finds them threatening the future local fiscal performance, or if they have a high probability of default, which would negatively affect the country's creditworthiness. However, the Ministry of Finance's approval of such borrowings will not amount to a state guarantee or prove the borrower's solvency. The Ministry's expertise is important due to lack of adequate expertise at the local level. The effectiveness of this procedure will be tested on the coming Kyiv City municipal Eurobonds issue scheduled for March.

In January 2003 the consolidated fiscal surplus reached UAH 1.45 bn compared to UAH 1.4 bn in January 2002. The month was marked by an exceptionally good performance of the central fiscal revenues due to a rather high economic growth, increases in some excise rates, as well as an improved tax administration. The execution rate of the general fund revenues was 100% as compared to 88% in January 2002. On the other hand, the execution rate of general fund expenditures was extremely low: 62% compared to 50% in January 2002. The accumulated fiscal surplus can be partially explained by the necessity to meet state debt obligations, in particular, the debt payments on Eurobonds due in March.

Monetary policy: The NBU makes refinancing loans more attractive for banks

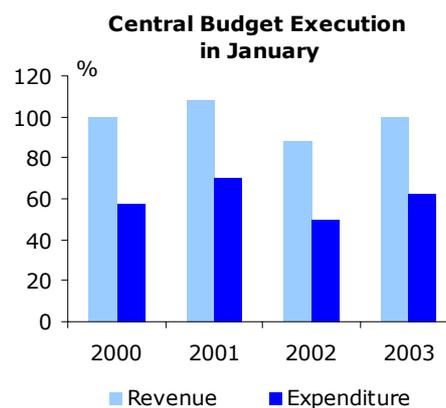
Following its promise to improve the refinancing conditions, the NBU introduced two changes to the refinancing procedures in February. First, the NBU abolished any collateral for overnight loans, disbursed through the constantly operating discount credit line. Second, the maximum duration for medium-term refinancing loans, allotted at special tender sessions, was lengthened from 9 to 12 months. These changes aim at increasing the attractiveness of NBU discount loans, which in turn would allow the NBU to conduct its monetary policy more flexibly.

In February the monetary base continued to grow at a slower rate, exhibiting only a 25.4% yoy increase. At the same time, compared to the previous year, the CPI shows a significant growth of 2.5% yoy, mainly explained by the very low price level in effect at the same time last year.

Financial markets: Ukrainian commercial banks were given the right to trade in Ukrainian Eurobonds

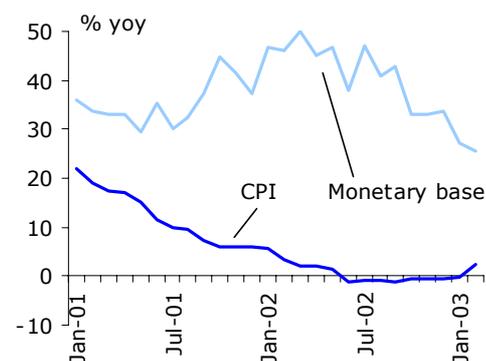
Government debt market. The NBU introduced a regulation that permits trading Ukrainian Eurobonds inside the country. According to this regulation, the commercial banks are allowed to purchase Eurobonds if they have a special NBU license and hard currency holdings. Banks are prohibited from buying hard currency at the inter-bank currency exchange, if intended for Ukrainian Eurobond purchases. Further, Eurobond trade inside the country is allowed only in hryvnia. This decision should increase demand for Ukrainian Eurobonds without creating an additional pressure on exchange rate.

Foreign exchange market. Ukraine experienced a large capital outflow during the past year, which, according to the Governor of the NBU Sergiy Tihipko, amounted to around USD 2.3 bn. In order to prevent capital flight, the NBU tightened several foreign market regulations. First, the purchase of domestic securities by residents from non-residents now requires a license. Second, the NBU will start to control prices for services provided by non-residents to residents. These measures may plug some capital flight loopholes, but it is very likely that capital outflow will continue in other ways.



Source: State Treasury

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

Price of Ukrainian Eurobonds in 2002-2003*



* Denominated in euro
Source: Art-Capital



Economic Trends		Q4 01	Q1 02	Q2 02	Q3 02	Q4 02	Nov	Dec	Jan	Feb
GDP growth (real)	% yoy	5.7	4.1	4.5	3.5	...	4.6	...	7.7	...
GDP growth (real)	% yoy cum.	9.1	4.1	4.3	4.1	4.1	4.1	4.6	7.7	...
Industrial production (real)	% yoy cum.	14.2	3.1	5.8	6.0	7.0	6.3	7.0	11.6	...
Agricultural production (real)	% yoy cum.	9.9	11.1	9.2	3.0	1.9	2.7	1.9	5.2	...
CPI	% yoy eop	6.1	2.2	-1.1	-1.1	-0.6	-0.4	-0.6	-0.1	2.5
PPI	% yoy eop	0.9	-0.5	4.0	4.9	5.7	5.3	5.7	6.8	6.8
Exports (USD)*	% yoy cum.	9.5	1.5	2.4	6.9	...	7.9"	10.4"
Imports (USD)*	% yoy cum.	14.1	-2.1	0.9	4.7	...	5.8"	7.6"
Merchandise trade balance	USD bn cum.	0.20	0.14	0.20	0.37	...	1.04"	0.98"
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	4.32	4.42	4.56	4.71
Monetary Base	% yoy eop	37.4	49.9	38.0	42.9	33.6	33.2	33.6	27.2	25.4
Lending rate on UAH credits **	% pa, eop	29.6	27.7	25.0	20.1	19.5	19.4	19.5	18.6	17.7
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	5.34	5.42	5.65	5.75

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	220.6
Nominal GDP	USD bn	37.0	44.6	50.2	41.9	31.6	31.8	37.8	41.4
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