

Monthly Economic Monitor Ukraine

- The President urged the nation to pursue his constitutional reform proposals for redistributing political power.
- Dezhkomstat revised the figure of the real GDP growth in 2002 upward from 4.1% to 4.6%.
- The increase in grain prices caused the President to ask for an investigation, which resulted in the filing of numerous criminal cases, including the arrest of former Vice Prime Minister Leonid Kozachenko.
- The payments discipline in the gas sector deteriorated.
- The current account balance reached USD 3.1 bn in 2002.
- Parliament adopted a new personal income tax law in second reading, which foresees a flat tax rate of 15%.
- Ukraine successfully met its first peak eurobond obligation in 2003.
- The banking system experienced a temporary liquidity shortage.

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April
2003**

Population: 48 m
Industry/GDP: 30.5%
Agriculture/GDP: 13.4%
Investment/GDP: 20.3%
Export destinations: Russia 22%, EU 17%
Import origins: Russia 34%, EU 20%

Politics: The President called for constitutional reform

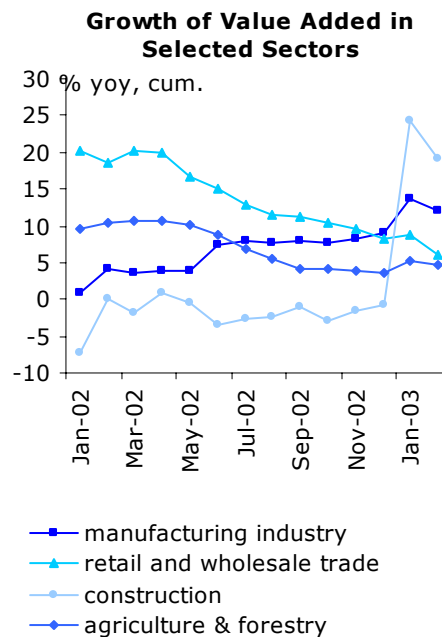
The President of Ukraine addressed the nation calling for constitutional reform and for the public discussion of his proposals. He elaborated on his proposals of August 24, 2002 in this address. The main idea of the proposed reform is to transform Ukraine into a parliamentary-presidential republic instead of the presidential-parliamentary, which it is now. Such a reform will curb the powers of the elected president and make the Verkhovna Rada more accountable.

The reaction of official Kyiv to the war in Iraq was contradictory. On the one hand, the Verkhovna Rada approved the proposal of the President of Ukraine to send a Ukrainian battalion for chemical, bacteriological and radioactive defence to Kuwait. While Ukrainian authorities stressed the defensive role of the Ukrainian participation, and the Minister of Foreign Affairs of Ukraine, Anatoliy Zlenko, ruled out the possibility of the Ukrainian battalion being used anywhere outside Kuwait, a statement of the White House listed Ukraine among the 48 countries of the coalition supporting the war in Iraq. On the other hand, the Verkhovna Rada adopted a resolution "On the Aggression of the USA and Great Britain against Iraq", in which it called for an immediate halt to the use of military power on the territory of Iraq. The resolution also calls for the return to peaceful means of resolving the situation with Iraq through the mechanisms of the United Nations.

Real economy: The real GDP growth in 2002 was revised upward to 4.6%

Derzhkomstat revised its estimate of the 2002 economic growth. According to refined, but still preliminary results, the real GDP grew by 4.6% yoy, compared to the previous figure of 4.1%. On the demand side, households remained the major contributor to the growth, while the role of fixed capital accumulation stays moderate. The fast growth of exports during the second half of the year 2002 allowed increasing the role of external growth demand. On the production side, the major growth came from value added increases in the manufacturing industry, the wholesale and retail trades, and agriculture.

For the first two month of the year the real GDP increased by 7.2% yoy continuing the trend started in January 2003. The highest growth rates of value added were observed in the manufacturing industry (12% yoy) and in construction (19% yoy). At the same time agriculture, as well as the wholesale and retail trades, major driving forces of growth at the beginning of the previous year, are constantly



Source: Derzhkomstat

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losing their positions. Agriculture increased by 4.8% yoy, while the trades achieved a 6% growth.

Sectoral trends: Grain prices are rising

Agriculture. Because of bad weather conditions endangering this year’s harvest, strong exports of grain during the second half of 2002, and recently revealed information that last year’s grain harvest volumes had been overestimated, the grain market participants expect lower grain inventories in Ukraine in 2003 accompanied by rising grain prices. Based on such expectations, farmers abstained from selling grain, waiting for higher prices. As a result, grain prices went up between January and March.

Since bread is known to be a socially important product in Ukraine, bread and grain prices are of great concern for the political powers and the grain market is subject to continuous interventions and administrative regulation. In order to prevent an increase in the bread price the State Reserve of Ukraine has begun selling grain and wheat flour in several regions. In addition, the Ministry of Agricultural Policy has asked grain traders to postpone the execution of signed export contracts and to sell milling wheat on the domestic market. Even more severe meddling has taken place this time. On the President’s request, the Office of the General Prosecutor investigated the grain market situation. In consequence of the investigation, 90 criminal cases were filed (as of the end of March), including a case against the former Vice Prime Minister Leonid Kozachenko, who was recently arrested. Aside from contravening basic market economy principles, such activities substantially increase the risk of operating at the grain market and may significantly impede development of the industry.

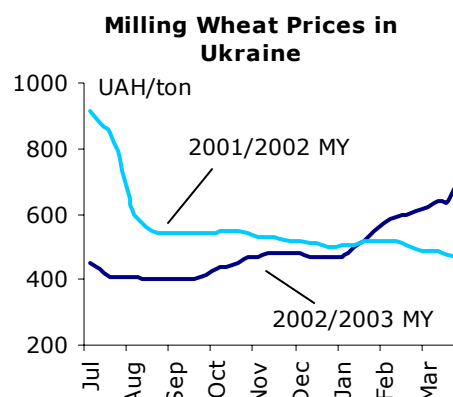
Energy. Power generation companies, subordinated to the Ministry of Fuel and Energy, drastically decreased payments for consumed natural gas, supplied by Naftogas in 2003. For the period of January to mid-March the level of their payments for natural gas reached only 22%. At the same time their receipts from the wholesale power market were much higher, amounting to 71% in January-February 2003. The deterioration in the payment discipline is mainly explained by the inability of Naftogaz to cut the gas supply to power generation companies due to their subordination to the Ministry. Softening budget constraints for power companies is likely to have a negative impact on the total payment discipline within the country and create a chain of arrears to the state.

External Sector: The current account surplus soared in 2002

The current account surplus increased by 126% yoy in 2002, exceeding USD 3.1 bn. That happened due to the growth in both balances of goods and services, as well as an acceleration of current transfers. For goods, one of the major reasons for growth was favorable world metal market conditions, as well as a boom in grain exports. For services, the positive development can to a major extent be attributed to the pre-agreed increase in the gas transit fee in the second half of the year.

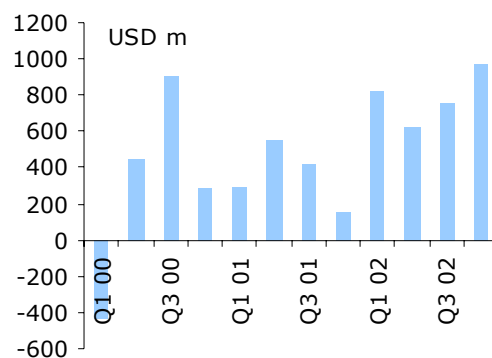
At the same time, according to the NBU, the inflow of foreign direct investments (FDI) into Ukraine decelerated by 20% yoy to USD 693 m in 2002, while the outflow of portfolio investments doubled, totaling USD 1.7 bn in 2002 only. While the FDI dynamics might be explained by Ukraine’s high-risk economy from the standpoint of foreign investors, the outflow of the portfolio investment is more likely to be a manifestation of domestic “capital flight”.

In March Ukraine further progressed on the way to the WTO accession. Specifically, three more protocols on access to goods and services markets were signed: at first with the EU, and then with the Czech and Slovak Republics. The signature of the protocol with the EU, one of the major players in world trade, should facilitate the agreements with other countries, in particular with EU accession countries.



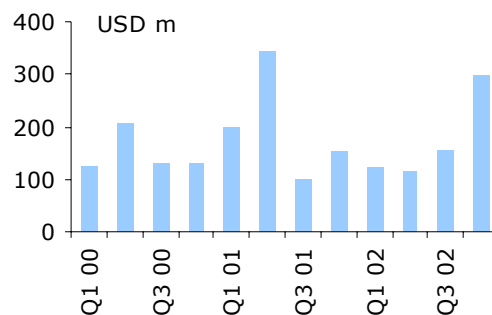
Sources: UkrAgroConsult; Ministry of Agricultural Policy of Ukraine
Note: EXW (ex works) price is shown; MY -- marketing year

Dynamics of Current Account



Source: NBU

Foreign Direct Investments



Source: NBU

Fiscal policy: New personal income tax rates adopted in second reading

Parliament adopted the Law on Personal Income Tax (PIT) in second reading, proposed by deputy Sergey Teryokhin. So far, the draft law sets a flat tax rate for personal incomes at the level of 15%. However, a set of important issues are postponed to the third reading. In particular, a reduced rate of 13% for transitional period till January 1st 2006 and an increase in non-taxable minimum from UAH 17 to the minimum wage level (currently UAH 185/month) will be reconsidered later. This draft differs dramatically from the current legislation: current personal income tax rates are 10, 20, 30 and 40%. The decrease of the tax rate is abrupt and, if adopted, will lead to a substantial reduction of the tax burden on citizens. At the same time, local public finance will be endangered, since receipts from the PIT are the major source of local fiscal revenues. However, possibly bringing many personal earnings out of the shadow economy might expand the tax base and at least partially compensate for the losses.

As of March 1, the central fiscal surplus reached UAH 1.78 bn. Revenues reached about 97% of budget due to the steady inflow of tax revenues. The main reason for the surplus is the under-execution of expenditures (75% for the first two months), some of which were suspended partially in order to assure the peak payments on Ukraine's eurobonds due in mid-March. These payments amounted to UAH 2 bn, constituting 36% of the external debt payments planned for this year. The next large payment is due in September.

Monetary policy: The necessity to repay foreign debt obligations shook the banking system

Suspending the fiscal expenditures due to the need to meet foreign debt obligations has led to an accumulation of substantial funds in the Treasury account at the NBU. Consequently, this money was not transferred to the real economy through the banking system, and commercial banks experienced a lack of liquidity, which was immediately reflected on the interbank market. The overnight interbank interest rate soared to 12% p.a., the highest level over at least a one-year period. In order to support the liquidity of the banking system, the NBU heavily used the refinancing mechanism. As a result, stability was restored, and the interbank interest rate reverted to its original state without spilling over into other interest rates. Meanwhile, the reduction of the NBU's foreign reserves caused by the external payments was partially compensated by interventions at the foreign exchange market, which have been continuously performed recently due to excess supply of foreign currency.

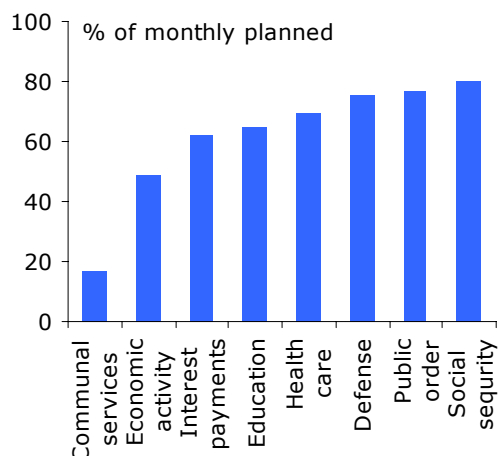
In March the slowdown of the monetary base growth to 24.4% yoy and the acceleration of inflation to 4.3% yoy continued.

Financial markets: Liberalisation of foreign exchange market continues

Foreign exchange market: The NBU continues the gradual liberalisation of the foreign exchange market. In March the restriction regarding the 5% fluctuation band of the cash exchange rate from the official one was lifted. Besides that, the National bank permitted banks to buy foreign currency, even if they have no commitments in this currency. This measure allows commercial banks to respond to changes at the world foreign exchange markets more quickly and hedge their risks.

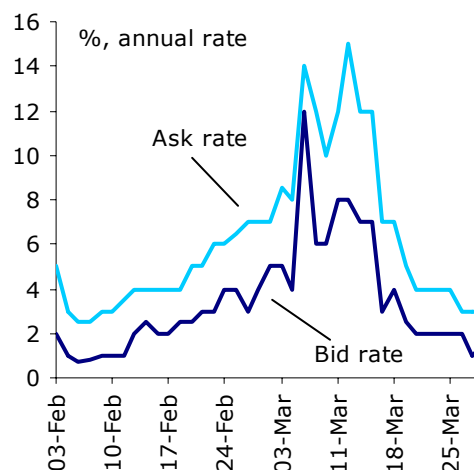
Banking sector: In consequence of frequent inquiries by people's deputies at the NBU to obtain information, which might infringe on banking secrecy, the National Bank applied to the Constitutional Court requesting it to examine the legality of such inquiries. The court's decision did not clarify the situation very much. The court confirmed the right of people's deputies to request information containing banking secrets, pointing out at the same time that the NBU is not obliged to provide it. From now on NBU officials have to consider each request individually, giving reasons for each answer.

Execution of Central Fiscal Expenditures in January-February



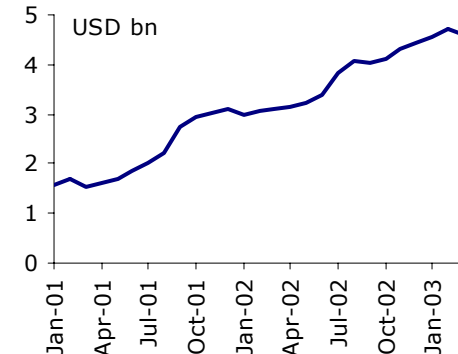
Source: State Treasury

Overnight Interbank Interest Rate Dynamics



Source: Ukrainian financial server

Liquid International Reserves of the NBU



Source: NBU



| Economic Trends | | Q4 01 | Q1 02 | Q2 02 | Q3 02 | Q4 02 | Dec | Jan | Feb | Mar |
|--------------------------------|-------------|--------------|--------------|--------------|--------------|--------------|------------|------------|------------|------------|
| GDP growth (real) | % yoy | 5.7 | 4.1 | 4.5 | 3.5 | ... | ... | 7.7 | 6.7 | ... |
| GDP growth (real) | % yoy cum. | 9.1 | 4.1 | 4.3 | 4.1 | 4.6 | 4.6 | 7.7 | 7.2 | ... |
| Industrial production (real) | % yoy cum. | 14.2 | 3.1 | 5.8 | 6.0 | 7.0 | 7.0 | 11.6 | 10.8 | ... |
| Agricultural production (real) | % yoy cum. | 9.9 | 11.1 | 9.2 | 3.0 | 1.9 | 1.9 | 5.2 | 4.3 | ... |
| CPI | % yoy eop | 6.1 | 2.2 | -1.1 | -1.1 | -0.6 | -0.6 | -0.1 | 2.5 | 4.3 |
| PPI | % yoy eop | 0.9 | -0.5 | 4.0 | 4.9 | 5.7 | 5.7 | 6.8 | 6.8 | 9.9 |
| Exports (USD)* | % yoy cum. | 9.5 | 1.5 | 2.4 | 6.9 | 10.7 | 10.4" | 22.7" | ... | ... |
| Imports (USD)* | % yoy cum. | 14.1 | -2.1 | 0.9 | 4.7 | 4.9 | 7.6" | 31.1" | ... | ... |
| Merchandise trade balance | USD bn cum. | 0.20 | 0.14 | 0.20 | 0.37 | 0.98 | 0.98" | 0.15" | ... | ... |
| Current account | USD bn cum. | 1.40 | 0.83 | 1.45 | 2.21 | 3.17 | x | x | x | x |
| Current account | % GDP | 3.7 | 10.6 | 8.3 | 7.5 | 7.6 | x | x | x | x |
| International reserves | USD bn eop | 3.09 | 3.11 | 3.41 | 4.02 | 4.42 | 4.42 | 4.56 | 4.71 | 4.60 |
| Monetary Base | % yoy eop | 37.4 | 49.9 | 38.0 | 42.9 | 33.6 | 33.6 | 27.2 | 25.4 | 24.3 |
| Lending rate on UAH credits ** | % pa, eop | 29.6 | 27.7 | 25.0 | 20.1 | 19.5 | 19.5 | 18.6 | 17.7 | 17.9 |
| 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 | 5.42 | 5.65 | 5.75 | 5.74 |

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 | 4.6 |
| 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 | 10.7 |
| Imports (gs, USD) | % yoy | 1.5 | 17.4 | 2.0 | -14.0 | -19.1 | 18.9 | 14.1 | 4.9 |
| Current account | USD bn | -1.2 | -1.2 | -1.3 | -1.3 | 0.9 ° | 1.2 °° | 1.4 | 3.1 |
| Current account | % GDP | -3.1 | -2.7 | -2.7 | -3.1 | 2.9 | 3.8 | 3.7 | 7.5 |
| FDI (net) | USD bn | 0.3 | 0.5 | 0.6 | 0.7 | 0.5 | 0.6 | 0.8 | 0.7 |
| 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 | 0.8 |
| Total public debt | % GDP eop | 40.9 | 25.0 | 30.3 | 49.4 | 61.4 | 44.5 | 37.4 | 34.4 |
| External debt (total) | % GDP eop | 26.3 | 20.5 | 19.4 | 38.4 | 50.0 | 32.5 | 26.8 | 24.7 |
| 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

° 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 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 |