



Monthly Economic Monitor Ukraine

- The Verkhovna Rada adopted the Program of the Government, thereby ensuring its continuance for one more year.
- The real GDP grew by 7% yoy during the first quarter of 2003 against a background of higher investment demand.
- Myhaylo Chechetov, the former first Deputy Head of the State Property Fund, became the new Head of the organisation.
- The positive trade balance was maintained, although the import of goods grew faster than exports.
- Execution of central fiscal revenues continued to exceed 100%, while the expenditures continued below budgeted levels.
- Higher than expected inflation dynamics caused the NBU to introduce inflation restraining measures.
- The Ministry of Finance chose lead managers for Ukraine's new eurobond issue scheduled for later this year.

**No.5 (31)
May
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: Parliament adopted the Program of the Government

By a 335-vote majority, including support from some opposition deputies, the Verkhovna Rada approved the Program of the Cabinet of Ministers of Ukraine. This program represents a comprehensive approach addressing many economic and social problems. It is well conceived, but the question remains whether it will be implemented or shelved, as have been many other "well-conceived" policies of previous governments. In any case, the adoption of the Program means that the Yanukovich government will be "safe" for one year, allowing it to implement its ambitious agenda on the eve of president's elections.

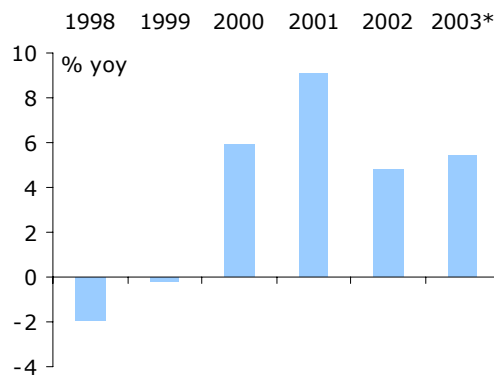
The parliamentary deputies continued to debate the President's proposed constitutional reforms. The proposal foresees a reduction in the number of deputies in the Verkhovna Rada, and a bicameral legislative branch. Opposition leaders fear that the creation of a bicameral parliament coupled with the right to disband the legislative branch could in fact increase the power of the President, rather than curb it. Moreover, the reform could be used as a pretext to prolong the term of the current president beyond 2004, when the next presidential election is scheduled. The reason for these suspicions is a clause in the proposal, which calls for the simultaneous election of the President and of the Verkhovna Rada. Debates also continue concerning the mode of deciding on constitutional changes: the deputies fear that any referendum could be manipulated by misleading the voters with ambiguously framed questions.

The Ministry of Foreign Affairs characterized the conference of the European Union in Athens on 16-17 of April as a success for Ukraine. The European Union indicated the possibility that Ukraine's might be invited to join organization. During the conference the President of Ukraine, Leonid Kuchma, had meetings with the EU Commissioner Xavier Solana, the President of France, Jacques Chirac, and with other European leaders.

Real economy: The role of investment demand in the real GDP growth increased

During the first quarter of 2003 the real GDP grew by 7.0% yoy compared to a 4.1% increase during the corresponding period of the previous year. The growth was based on positive dynamics in the manufacturing industry, constructions and transport, while at the beginning of 2002 the major driving forces were agriculture and the retail and wholesale trades. The change in the sources of value added growth indicates a shift in the economy's demand structure, i.e. higher investment instead of final consumption demand.

Real GDP Growth



Source: Derzhkomstat
* own forecast

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From January to March industrial output increased by 10.7% yoy with the highest growth registered in wood production, the food industry, metallurgy, and machine building. While the increase in metal production is external-demand driven, growths in machine building as well as in construction are a sign of the intensification of the investment activity within the country.

Sectoral trends: The State Property Fund got a new Head

Privatisation. The Parliament of Ukraine has approved the dismissal of the Head of the State Property Fund (SPF), Olexandr Bondar, and the appointment of Myhaylo Chechetov, the former first Deputy Head, to this position. The official reason for the dismissal of Olexandr Bondar, who headed the SPF since 1998, was the inadequate execution of the privatisation plan in 2002.

According to the State Treasury, the privatisation receipts for the first quarter of 2003 were only UAH 278 m, while UAH 548 m had been planned for this period. At the same time, Myhaylo Chechetov also announced that the SPF had sold UAH 700 m of state property from January to March, including UAH 450 m for the 25% stake in the mobile phone operator UMC. However, none of the UMC earnings have so far been transferred to the state coffers. The state hopes to collect UAH 2.15 bn in privatisation receipts this year.

Energy. During the first quarter of 2003 the Ukrainian oil company Naftogaz exported 2.5 billion cubic meters (bcm) of natural gas. That became possible for the first time in 2003 because Ukraine obtained the right to re-export surplus gas received from Russia in payment for transit services, as well as gas imported from Turkmenistan. Until 2003 the export of natural gas from Ukraine was prohibited by the Ukrainian-Russian bilateral agreements. According to the Naftogaz Head Yuriy Boyko, Naftogaz is going to export 6.5 bcm of natural gas in 2003, 5 bcm of which represent Gazprom contracts for gas supplies to Europe.

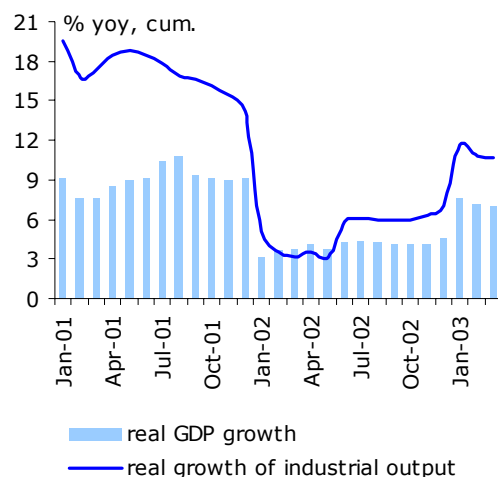
External Sector: A positive trade balance was preserved despite high import growth rates

For the first two months goods exports grew by 23.8% yoy in dollar terms, while imports increased by 30.0%. Still a positive balance of trade was preserved at the level of USD 284 m. On the export side, the major growth driving force was ferrous metals, exports of which increased by 43% yoy throughout the reported period due to favorable world market conditions. The second important source of growth was exports of mineral products, in particular gas re-exports and sales of petroleum processing products.

On the other hand, imports of mineral fuel, oil and petroleum processing products grew by 37% yoy for January and February 2003, due to the growth of oil prices and the continuous development of the Ukrainian petroleum processing industry. Growth of machinery and equipment (33% yoy), as well as transports imports (72% yoy) are an additional indication of increased investment demand within the country.

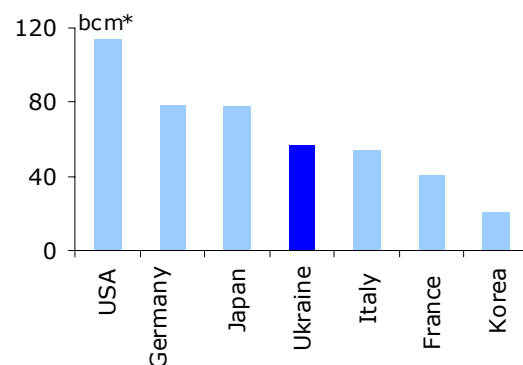
In April Ukraine abolished the ban on chicken meat imports from the USA, introduced in January 2002. The ban was imposed because US producers use antibiotics and antimicrobials that are forbidden in Ukraine. Imported chicken meat from the USA must in future carry a specific certificate testifying that no antibiotics and antimicrobials were used in the production and preservation processes. The resolution of this problem represents one more step towards a normalization of trade relations between the USA and Ukraine.

GDP and Industrial Output



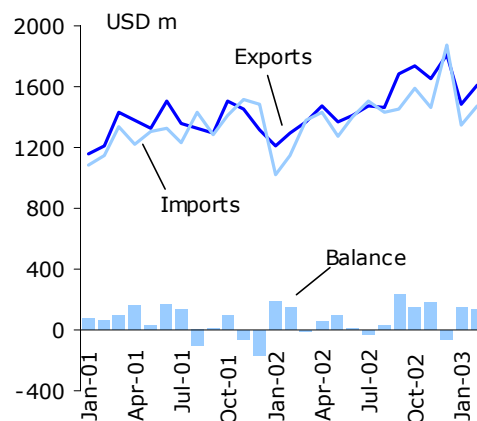
Source: Derzhkomstat

Major Natural Gas Importers in 2001



*billion cubic meters
Source: International Energy Agency

Merchandise Trade Dynamics



Source: Derzhkomstat

Fiscal policy: The central fiscal revenue receipts continue to exceed budget

For the period of January-March 2003, the central fiscal revenues were UAH 9.06 bn, or 101% of the planned collections. The high execution rate for tax revenues (103.9%) can be explained by the fact that the macroeconomic indicators were higher than expected. However, according to the State Tax Administration, tax arrears increased by 3.4% since January, reaching UAH 15.2 bn.

After the successful servicing of the peak foreign debt obligations in March, the level of central fiscal expenditures increased in comparison with previous months and reached 89% of the budgeted amount for the quarter totalling UAH 8.17 bn. The state fiscal surplus reached UAH 1.4 bn.

Monetary policy: CPI dynamics caused the NBU to implement inflation restraining measures

The growth of consumer prices at the beginning of the year has evoked noticeable concern by monetary officials. Though there was no indication that the inflation had been provoked by money supply dynamics, the NBU decided that inflation restraining measures should be implemented.

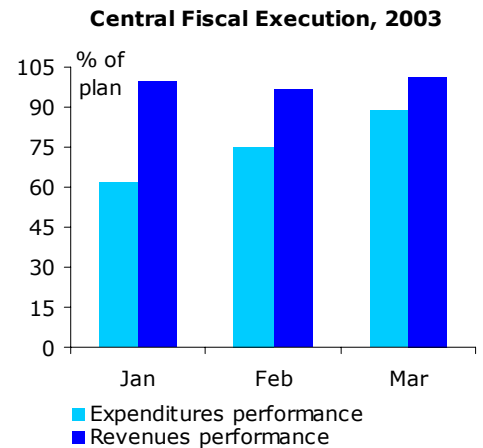
As a consequence, the NBU Council decreased the projected UAH/USD exchange rate for the current year from 5.48 UAH/USD aop to 5.39 UAH/USD aop. This means that in 2003 the hryvnia will be devalued by approximately 2% instead of the previously projected 5%. This is a very small adjustment, which is not likely to have a significant impact on inflation through prices of imported goods. The major effect is expected to come from the strong signalling feature of the exchange rate and its influence on inflation expectations in Ukraine.

In April the NBU also attempted to use sterilisation measures. Because the government bonds market is underdeveloped, the National Bank is deprived of the possibility to go to the open market and make use of the most efficient sterilisation instruments of monetary policy. As a result, the NBU reverted to the previous practice of issuing specially designed certificates of deposits (CDs). However, during the first auction held at the end of April, none of the CDs were sold. This failure may be attributed to the quite low interest rate set for this auction. Provided the interest rate will be acceptable to commercial banks at future auctions, the NBU will be able to sterilise the money supply to some extent. However, the development of a market for government bonds remains an important prerequisite for effective sterilisation operations.

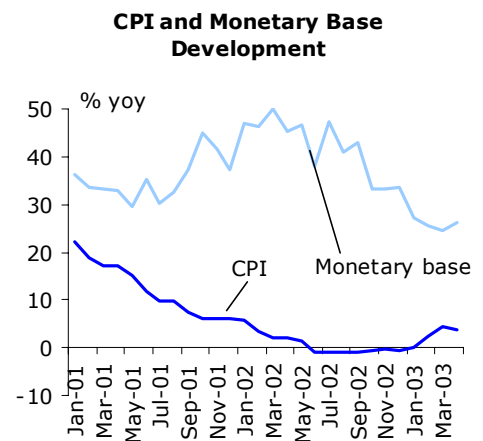
Though the 3.6% yoy CPI increase in April was less than during the previous month, this should be attributed to a statistical base effect rather than to results of the NBU policy. The monetary base grew by 26.3% yoy.

Financial markets: Ukraine chose lead managers for its next eurobonds issue

Government debt market. The Ministry of Finance chose three large Western banks – JP Morgan, UBS and Dresdner Bank – to be lead managers for Ukrainian eurobond issues. The planned amount of the new 2003 issue is USD 600 m. The Ministry of Finance plans to reduce the eurobond yield rate from 11%, at which Ukraine sold the last issue in December 2002, to approximately 8.5%. Unfortunately for Ukraine, international investors are not as optimistic: the international rating agency Standard & Poor's (S&P) confirmed Ukraine's "B" rating with a negative outlook. S&P believes the budgeted privatization revenues to be overestimated, cooperation between the Verkhovna Rada and the Cabinet of Ministers to be poor, and also expresses concerns about the stalled progress on long discussed key issues, such as adoption of a new Tax Code.



Source: State Treasury



Source: Derzhkomstat, NB U



* Denominated in euro
Source: Art-Capital



Economic Trends		Q1 02	Q2 02	Q3 02	Q4 02	Q1 03	Jan	Feb	Mar	Apr
GDP growth (real)	% yoy	4.1	4.7	4.3	6.1	...	7.7	6.7	6.6	...
GDP growth (real)	% yoy cum.	4.1	4.4	4.3	4.8	7.0	7.7	7.2	7.0	...
Industrial production (real)	% yoy cum.	3.1	5.8	6.0	7.0	10.7	11.6	10.8	10.7	...
Agricultural production (real)	% yoy cum.	11.1	9.2	3.0	1.9	1.3	5.2	4.3	1.3	...
CPI	% yoy eop	2.2	-1.1	-1.1	-0.6	4.3	-0.1	2.5	4.3	3.6
PPI	% yoy eop	-0.5	4.0	4.9	5.7	9.9	6.8	6.8	9.9	8.9
Exports (USD)*	% yoy cum.	1.5	2.4	6.9	10.7	...	22.7"	23.8"	27.9"	...
Imports (USD)*	% yoy cum.	-2.1	0.9	4.7	4.9	...	31.1"	30.0"	28.0"	...
Merchandise trade balance	USD bn cum.	0.14	0.20	0.37	0.98	...	0.15"	0.28"	0.41"	...
Current account	USD bn cum.	0.83	1.45	2.21	3.17	...	x	x	x	x
Current account	% GDP	10.6	8.3	7.5	7.6	...	x	x	x	x
International reserves	USD bn eop	3.11	3.41	4.02	4.42	4.60	4.56	4.71	4.60	4.87
Monetary Base	% yoy eop	49.9	38.0	42.9	33.6	24.3	27.2	25.4	24.3	26.3
Lending rate on UAH credits **	% pa, eop	27.7	25.0	20.1	19.5	17.9	18.6	17.7	17.9	18.3
Exchange rate (official)	USD aop	5.32	5.33	5.33	5.33	5.33	5.33	5.33	5.33	5.33
Exchange rate (official)	EUR aop	4.66	4.88	5.24	5.33	5.71	5.65	5.75	5.74	5.78

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)

°° 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.

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	220.9
Nominal GDP	USD bn	37.0	44.6	50.2	41.9	31.6	31.8	37.8	41.5
GDP growth (real)	% yoy	-12.2	-10.0	-3.0	-1.9	-0.2	5.9	9.2	4.8
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