



Monthly Economic Monitor Ukraine

- A Group of high-ranking officials from Russia, Belarus, Ukraine, and Kazakhstan has agreed on the principles for establishing a Common Economic Area.
- Two constitutional reform proposals were submitted to the Constitutional Court.
- The real GDP grew by 7.5% yoy in first half of 2003.
- Parliament adopted the law "On Telecommunications", which should solve some major legal problems in the sector.
- Administrative pressure aimed at reducing bread prices continues.
- Ukraine takes more steps toward the WTO.
- The three-pillar pension system was adopted by Parliament.
- In July the consumer prices grew by 7.4% yoy.
- The President signed two laws concerning mortgages.

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August
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: A high-level meeting concerning establishment of a Common Economic Area took place in Moscow

On July 25, the 6th meeting of the Group of high-ranking officials from Russia, Belarus, Ukraine, and Kazakhstan charged with the establishment of a Common Economic Area (CEA) took place in Moscow. Delegations of experts and officials, headed by the vice-prime ministers, agreed on the configuration and content of the package of documents that will be submitted to the presidents of the four countries in September. According to the agreement, the requirements concerning accession will be equal for all participants, but each country can move toward the CEA at its own pace. Before submitting the package of documents to the presidents, they will be reviewed and agreed to at a meeting, which will be held in Kyiv in early August. Despite the progress, the significant economic and institutional differences between the four countries are likely to evoke long debates and negotiations about further unification steps. As regards Ukraine, participation in the CEA does not conform to the officially proclaimed "European choice" strategy, which declares the country's desire to move towards joining the European Union.

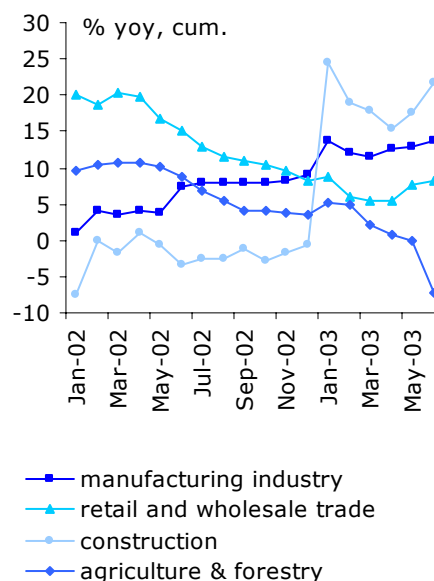
The debate about the constitutional reform continues in the Constitutional Court of Ukraine. In July two proposals were submitted to the Court for assessment: one prepared by Parliament and the other initiated by President Kuchma. The submission procedure evoked heated disputes among the people's deputies and work in the Verkhovna Rada was stalled for several days. Yet, irrespective of the Constitutional Court's decision, the constitutional reform is not likely to be implemented prior to the presidential elections.

Real economy: The real GDP growth continues

During the first half of 2003 the real GDP grew by 7.5% yoy. As before, the highest growth rates of value added were in construction (21.8% yoy), manufacturing (13.7% yoy), and transport (9.2% yoy). In line with expectations, the growth rate of value added in agriculture became negative, reaching -7.2% yoy. If the trend in agriculture continues, it is likely to slow the overall GDP growth during the second half of the year.

In July Derzhkomstat revised the GDP growth figure for the first quarter of 2003, adjusting it upwards from 7.0% yoy to 7.9% yoy. Major changes concerned the growth of value added in transport, in trade, and in agriculture. On the expenditure side of the real GDP, both the final consumption and investment demand stimulated the growth. In particular, household consumption grew by 11.4% yoy, while gross fixed capital increased by 15% yoy. The accumulation of gross fixed capital corresponds with the growth observed in machine building and construction.

Growth of Value Added in Selected Sectors



Source: Derzhkomstat

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Sectoral trends: A new law on telecommunications was adopted

Infrastructure. The Verkhovna Rada adopted the law "On Telecommunications" repealing the old law "On Communications" and the recently passed divisive amendment about free incoming calls. The new law introduces an independent regulatory institution, the National Communications Regulation Commission, responsible for tariff and licensing policy. Thus, the problem of a market regulator independent of the executive bodies will be solved positively.

Mobile TeleSystems (MTS), the largest Russian mobile telecommunications company, extended its holding in UMC to full ownership by purchasing 16,3% of the company shares from the Danish TDC Group. Earlier on, MTS had declared the full take-over of the Ukrainian company, including trademark replacement. This recent purchase makes MTS the largest cellular connection provider in the region, increasing the competition at the Ukrainian market.

Agriculture. After the food panic and the sharp increase in food prices in June, the government put substantial administrative pressure on all market agents. The central government ordered the local authorities to stabilize the food markets by all means at their disposal. Some regions imposed barriers to movements of newly harvested grain; all regions are regulating the prices for bread, flour and groats by setting ceiling prices and restricting mark-ups and profitability rates. The prosecutors' offices, all services of the Ministry of Internal Affairs, the Antimonopoly Committee, sanitary inspections and other state institutions are all involved in regulating commodity movements and food prices, and inspecting the activities of traders and producers. Searching for scapegoats responsible for the food crisis, the governors of the Chernivtsi, Dnipropetrovsk, and Poltava oblasts were dismissed. However, these government policies had little success and did not influence prices much.

For the first time import quotas for raw cane sugar were sold at auction in July. Before this a practice of distributing quotas on a subjective basis had prevailed. Quotas for 200 000 tons of raw cane sugar were sold this time, and quotas for 360 000 tons are going to be traded in August. That can be seen as a step towards a market-based governance of the agricultural sector.

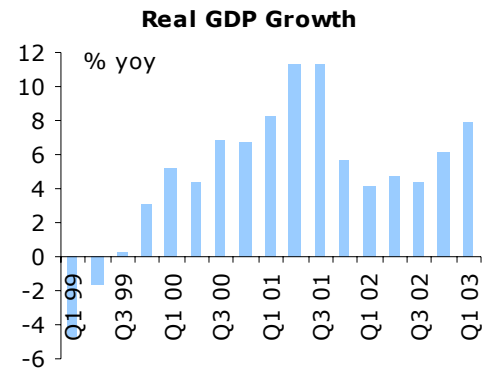
External Sector: Ukraine takes more steps toward the WTO

In July Ukraine and Bulgaria signed agreements on access to goods and services markets within the framework of Ukraine's WTO accession. This is the 14th out of 33 bilateral agreements that are to be signed by Ukraine. The number of countries that want to sign separate bilateral agreements has increased recently, after Estonia, Thailand, Israel, Panama, and Paraguay expressed their intention to negotiate trade agreements with Ukraine. Ukraine declared that it plans to become a member of the WTO by the end of 2004. To that end, Ukraine still needs to complete both bilateral and multilateral negotiations, and prepare a Protocol on Accession.

According to Derzhkomstat, exports of goods grew by 27% yoy between January and May, while imports increased by 29%. The positive trade balance was preserved at the level of USD 455 m. Exports to Europe increased by 37% yoy, to the CIS countries by 29%, and to Asia by 11%. This differs significantly from the export flows during the respective period of the previous year, when the trade with Asia was leading. However, the regional pattern of Ukraine's export remains highly diversified.

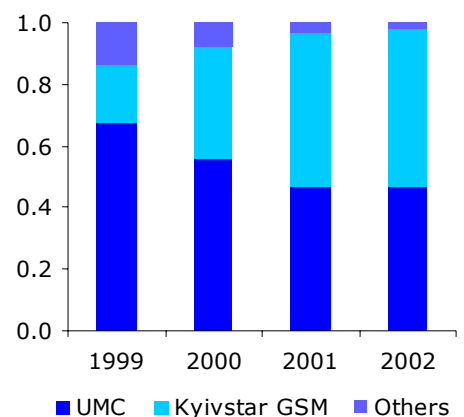
Fiscal policy: Parliament introduces the three-pillar pension system

The Verkhovna Rada adopted two pension laws, which introduce the three-pillar pension system. Two compulsory pillars are defined in the law "On Compulsory State Pension Insurance". According to this



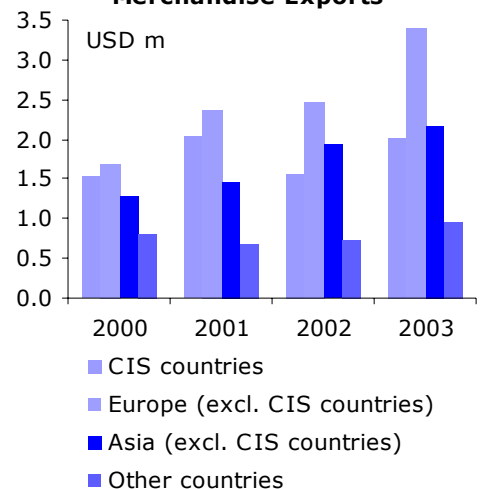
Source: Derzhkomstat

Market Shares* of Mobile Communication Providers in Ukraine



Source: data of the companies
*measured by number of customers

Regional Distribution of Merchandise Exports*



Source: Derzhkomstat
* data for January – May of a respective year

law, both employees and employers, including self-employed people, will have to contribute to the pay-as-you-go system, the first pillar. The ceiling for pension benefits will be eliminated and any deficit of the first pillar will be financed by the State. The size of the pension benefits will depend on the insurance record, i.e. on the size of the pension contributions made and the length of the payment period. The second pillar, the compulsory accumulation system, will be introduced after Ukraine reaches certain economic prerequisites. The compulsory pension contributions, paid by employees, will be transferred to individual pension accounts, supervised by the Accumulation Fund. The law maintains the same retirement age as before, however, it also permits late retirement with increased pension benefits. The third pillar, a voluntary non-state system of pension savings, is defined in the law "On Non-State Pension Provisions" and envisages the existence of non-state pension funds. The adoption of these laws is the first major step towards pension reform in Ukraine, aiming at increasing the living standards of pensioners and ensuring the sustainability of the pension system.

In July Parliament approved amendments to the law "On the State Budget 2003". In contrast to the previous amendments introduced in May, the fiscal deficit was increased, since the higher expenditures could no longer be fully covered by higher revenues. In particular, fiscal expenditures were increased by 1.6%, revenues by 0.5%, and the deficit by 29% (to 1.1% of GDP). The increased expenditures are aimed at supporting agriculture, financing the transfer of local budgets to the unified Treasury Service, and providing the Autonomous Republic of Crimea with additional equalization transfers to stabilize its fiscal position. The higher deficit is planned to be financed through eurobonds in the amount of USD 112.5 m.

Between January and June the central fiscal surplus reached UAH 1.05 bn. The central fiscal revenues reached 102% of budget, while expenditures remained at the same level as the previous month, i.e. at 92% of budget.

Monetary policy: Inflation accelerates

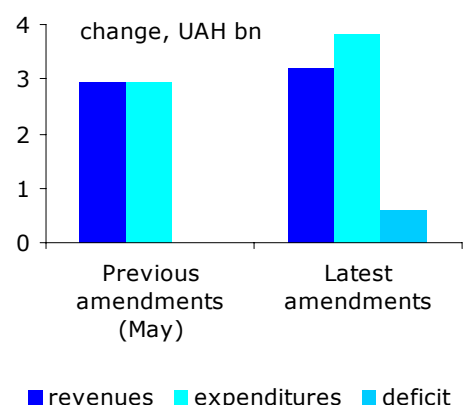
The recent consumer panic raised concerns over the consequences of the food-products price increases on the inflation dynamics and the whole macroeconomic situation. In July the consumer prices grew by 7.4% yoy and the monetary base increased by 29.3% yoy. Although the growth of the monetary base and the money supply exceeded projected limits, it is very unlikely that inflation was caused by monetary factors, hence monetary contraction would be ineffective in curbing prices. Should inflation continue, the National Bank of Ukraine and the commercial banks might want to raise the nominal interest rates in order to keep the real interest rate positive.

Financial markets: The legislative base for mortgages broadens

Banking sector. The President signed two laws on mortgage: the first one deals with mortgage certificates, the second with mechanisms for financing construction activities. Both laws concern very important aspects of mortgage lending, but they have incurred criticism from many sides and would definitely require amendments before January 2004, when they will come into force.

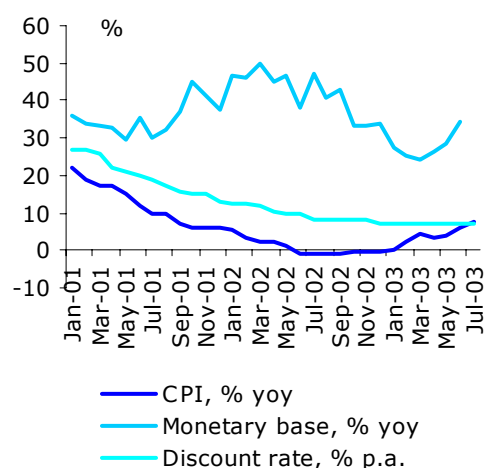
Reacting to the situation at the grain market, the National Bank of Ukraine set forth its own measures. First, the NBU urged commercial banks to restructure the debts of agricultural enterprises for 1 year at an 18% annual interest rate. Out of the 18%, 16 percentage points will be paid by the state, while the farmers will pay only 2 percentage points. Second, the NBU will disburse refinancing loans to those commercial banks, which are willing to finance agricultural traders to import grain. Although these state supportive actions may improve the financial position of the sector, they will put additional pressure on state finances and are likely to give wrong incentives to agricultural enterprises.

Changes to the State Budget 2003



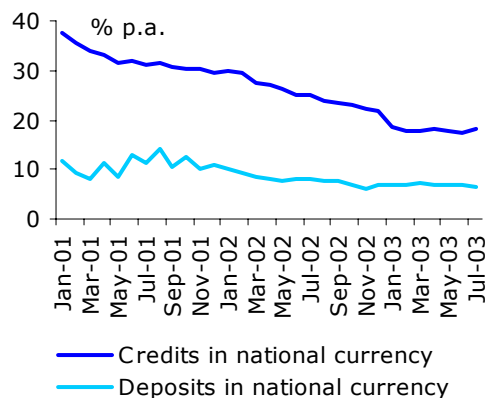
Source: Verkhovna Rada

CPI, Monetary Base, and Discount Rate



Source: Derzhkomstat, NBU

Average Interest Rates of Commercial Bank



Source: NBU



Economic Trends		Q1 02	Q2 02	Q3 02	Q4 02	Q1 03	Mar	Apr	May	Jun	Jul
GDP growth (real)	% yoy	4.1	4.7	4.3	6.1	7.9	6.6	7.4	8.3	8.3	...
GDP growth (real)	% yoy cum.	4.1	4.4	4.3	4.8	7.9	7.0	7.1	7.3	7.5	...
Industrial production (real)	% yoy cum.	3.1	5.8	6.0	7.0	10.7	10.7	11.4	11.7	12.4	...
Agricultural production (real)	% yoy cum.	11.1	9.2	3.0	1.9	1.3	1.3	0.6	0.2	-6.0	...
CPI	% yoy eop	2.2	-1.1	-1.1	-0.6	4.3	4.3	3.6	3.9	5.9	7.4
PPI	% yoy eop	-0.5	4.0	4.9	5.7	9.9	9.9	8.9	7.6	5.3	5.3
Exports (USD)*	% yoy cum.	1.5	2.4	6.9	10.7	24.6	27.9"	27.8"	27.1"
Imports (USD)*	% yoy cum.	-2.1	0.9	4.7	4.9	22.8	28.0"	29.1"	29.2"
Merchandise trade balance	USD bn cum.	0.14	0.20	0.37	0.98	0.32	0.41"	0.41"	0.46"
Current account	USD bn cum.	0.83	1.45	2.21	3.17	1.08	x	x	x	x	x
Current account	% GDP	10.6	8.3	7.5	7.6	11.9	x	x	x	x	x
International reserves	USD bn eop	3.11	3.41	4.02	4.42	4.60	4.60	4.87	5.30	6.17	6.52
Monetary Base	% yoy eop	49.9	38.0	42.9	33.6	24.4	24.4	26.3	28.6	34.2	29.3
Lending rate on UAH credits **	% pa, eop	27.7	25.0	20.1	19.5	17.9	17.9	18.3	17.9	17.2	18.2
Exchange rate (official)	USD aop	5.32	5.33	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	5.74	5.78	6.14	6.23	6.07

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