

# Monthly Economic Monitor Ukraine

**No.10 (36)  
October  
2003**

- The presidents of Ukraine, Russia, Belarus and Kazakhstan signed a treaty to establish a Common Economic Space.
- Despite the decline in agriculture, the real GDP continued its growth at 5.3% yoy from January to August.
- A price increase of petroleum products provoked administrative interventions in the market.
- The government continues with administrative price controls on the grain and sugar markets.
- Ukraine and Cuba signed a protocol on accession for goods and services within the framework of the WTO negotiations.
- The foreign direct investment inflow increased considerably.
- The NBU Council approved the main guidelines for the 2004 monetary policy. They do not envisage substantial policy changes.
- The deposit insurance coverage was increased by one third from UAH 1500 to UAH 2000.

## Politics: Ukraine, Russia, Belarus and Kazakhstan launched the establishment of the Common Economic Space

On September 19 the presidents of Ukraine, Russia, Belarus and Kazakhstan signed a treaty to establish the Common Economic Space (CES). The treaty foresees the establishment of a customs union with no tariffs inside the CES and common tariffs at the external border, as well as the coordination of foreign trade and macroeconomic policy. Countries can choose the speed of their integration into the CES. A further important element of the treaty is the coordination of WTO accession activities, including the condition that no demands are made on other CES participants should one member join the WTO earlier than the rest. The CES is to be managed by a single regulatory body, in favour of which the countries will delegate parts of their authority. The decisions of this regulatory body are mandatory for all member countries. The role of each country in the decision-making process of the regulatory commission will depend on the "economic potential" of the country. Ratification of the treaty is likely to raise a heated debate in Parliament. The major bones of contention are the planned establishment of a customs union and of supranational structures that contradicts the Constitution of Ukraine, and could hamper Ukraine's WTO accession process and European integration initiatives.

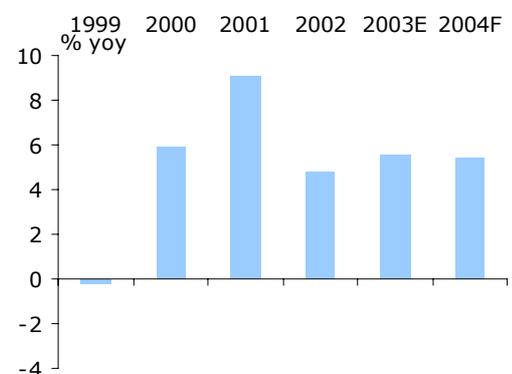
On September 29 the Parliamentary Assembly of the Council of Europe (COE) adopted a resolution on Ukraine's progress in fulfilling its commitments to the COE. Although some positive developments were noted in the resolution, the Assembly decided "to pursue the monitoring procedures with respect to Ukraine". In part that means that a special COE mission will be sent to Ukraine to follow the preparations for and conduct of the next presidential elections in Ukraine. Ukrainian authorities were trying to avoid continuation of the monitoring status, however they were unable to change the long list of problems within Ukraine including censorship, failure to solve crimes against journalists, pressure on judges, and incompatibility of the criminal code with COE standards.

## Real economy: GDP grew by 5.3% yoy

The real GDP increased by 5.3% yoy during the first eight months of the year. As before, the decline of the value added in the agricultural sector (-24.6% yoy) was to the large extent counterweighted by the high growth rates in manufacturing, construction, transport and trade. Industrial output grew by 14.6% yoy from January to August mainly due to the high growth rates in machine building (32.8% yoy)

**Population: 48 m**  
**Industry/GDP: 30.5%**  
**Agriculture/GDP: 13.4%**  
**Investment/GDP: 20.3%**  
**Export destinations: Russia 17%, EU 20%**  
**Import origins: Russia 35%, EU 23%**

**Real GDP Growth**



Source: Derzhkomstat  
 E -- own estimate; F -- own forecast

Institute for Economic Research  
 and Policy Consulting  
 Reitarska 8/5-A, 01034 Kyiv  
 Tel. (+38044) 228-6342  
 Fax (+38044) 228-6336  
 E-mail: [institute@ier.kiev.ua](mailto:institute@ier.kiev.ua)  
<http://www.ier.kiev.ua>

and metallurgy (13% yoy). The expansion of these sectors reflects the growth of both internal investment demand and external demand – the forces that determine this year's economic growth. According to our forecast, the real GDP growth in 2003 will be 5.6%.

The positive developments in the economy are also reflected by the reduction in overdue enterprise payables and receivables. In July overdue receivables declined by 11% yoy after continuously increasing for almost a year and a half, while overdue payables dropped by 5% yoy, indicating better payment discipline and, hence, a healthier business environment.

### Sectoral trends: The state continues its administrative regulation of the markets

**Energy.** In September prices for oil products in Ukraine increased by 5 to 15% due to growing crude oil prices, a high seasonal demand for petroleum products from the agricultural sector, and the re-export of oil from Ukraine. The government reacted by imposing administrative measures. Ukrzaliznytsya banned oil and oil products export shipments from refineries. In addition, the Cabinet of Ministers introduced a procedure requiring oil export contracts to be registered with the central government. Such administrative interventions in the marketplace are likely to disrupt the proper functioning of the refineries as they become overstocked with product inventory. These interventions can be considered as a move away from a market-oriented economic policy.

**Privatisation.** Parliament has yet again failed to adopt a privatisation program for 2003-2008. The most controversial items in the debated proposals were to privatise large vertically integrated companies operating in the defense, coal mining, energy, and oil and gas sectors, and the plan to conduct privatisation contests, in which only invited participants could submit bids. Since the State Property Fund will now have to prepare a new program proposal, some delays with privatisation are possible.

**Agriculture.** From the beginning of the harvest season till September 1, 13.3 m tons of grain were harvested in Ukraine, which amounts to only 37.2% of last year's harvest. Due to poor harvests in the world in general, the world market price remains high, which the domestic grain prices reflect. Despite continuing increases in the grain and flour prices in Ukraine, retail prices for staple food products in most regions remained stable due to severe government regulation, which is supposed to continue until the end of the year.

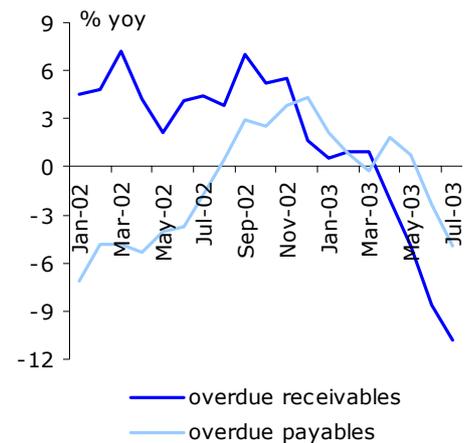
The sugar market situation is quite the opposite. A month ago the government was concerned about sugar prices being too high, threatening the food security of the poor. Hence it implemented administrative measures to reduce the price. Today the sugar price has fallen below the official minimum price and the government now takes measures to increase the market price again. To this end, the State Reserve plans to purchase sugar.

### External Sector: Ukraine signed one more bilateral protocol within the framework of the WTO accession

Despite the plan to establish a Common Economic Space, Ukraine continues its negotiations towards WTO accession. In September Ukraine and Cuba signed a protocol on the accession to goods and service markets, the fifteenth protocol on accession out of the 33 that Ukraine has to sign.

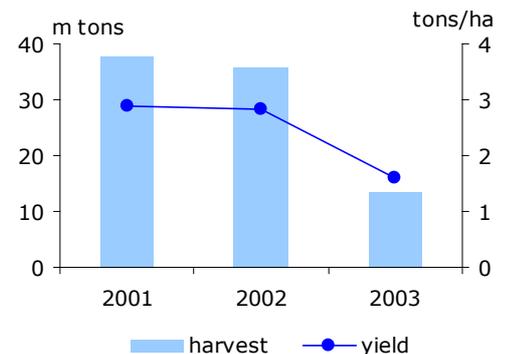
According to the NBU, the current account balance remained positive during the first half of 2003 amounting to USD 1.82 bn, due to both a positive trade balance for goods and services and growing current transfers. At the same time, the foreign direct investment (FDI) inflow grew by more than 200% yoy, and reached USD 748 m. To reach this amount of FDI inflow required the whole year in 2002. Almost a quarter of this inflow is attributable to the purchase of the telecommunications company UMC by the Russian MTS. Also sales of

### Enterprise Overdue Receivables and Payables



Source: Derzhkomstat

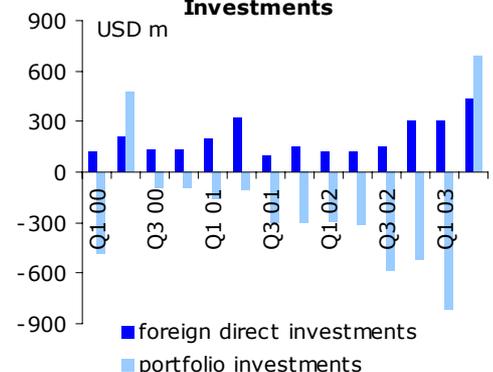
### Ukrainian Grain Harvest\*



Sources: Derzhkomstat

\*from the beginning of harvest season till September 1 (for 2001 till September 10)

### Foreign Direct and Portfolio Investments



Source: NBU



USD 800 m of Ukrainian eurobonds contributed to the inflow of portfolio investments in the second quarter, making them positive for the first time since 2000.

### Fiscal policy: The 2004 budget draft was submitted to parliament

For the first time since adoption of the Budget Code the draft law on next year's budget was submitted to parliament before the deadline. The draft was calculated using reduced tax rates on personal income and enterprise profit. Central fiscal revenues and expenditures for the year 2004 are planned at the levels of UAH 58.2 bn and UAH 59.9 bn respectively. Despite the risk that not all the planned tax revenues will be collected due to the lower tax rates and the uncertain increase in the tax base, the draft budget seems realistic.

Parliament voted again for amendments to VAT law, introducing a tax rate of 17% instead of 20%. Some of President's suggestions were incorporated to the law, such as preserving the exemption for sales of medicines. However, the budget draft did not account for the VAT rate reduction, since the amendments are not signed yet. Therefore, there is a possibility that the budget figures will be recalculated despite the prohibition in the Budget Code.

### Monetary policy: The main guidelines for the 2004 monetary policy were approved

In September the Council of the NBU reviewed the projected level of money supply expansion for the current year. The yearly growth rates of the monetary aggregates were increased by a factor of approximately two and now correspond to the actual developments in the monetary sector. By the end of September the growth rates of the monetary base and the money supply were 31% yoy and 47% yoy respectively. Consumer prices continued to grow at the previous pace reaching 6.2% yoy.

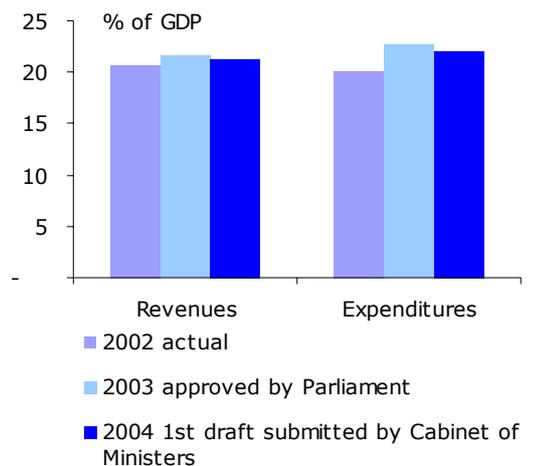
According to "The Main Guidelines for Monetary Policy for 2004" approved by the NBU Council, there will be no major changes in the monetary and exchange rate policies next year. The growth rates of the monetary base and the money supply are estimated at 26 to 32% yoy and 32 to 39% yoy respectively. This dynamic of the monetary aggregates is expected to satisfy the continued expansion of the money demand without creating additional pressures on prices, which are forecast to grow by 6% yoy by the end of 2004. The hryvnia is going to be devalued slightly with respect to US dollar, so that the average exchange rate during the year will be within the 5.38 to 5.42 UAH/USD band. The approved indicators look quite realistic, and will most probably not require major adjustments near the end of the year as usually happened in the past.

### Financial markets: The insurance coverage for deposits was increased

**Banking sector.** The Deposit Insurance Fund (DIF) has increased the amount of deposit coverage from UAH 1500 to UAH 2000. This step gives depositors greater incentives to place larger amounts of money in the banking system and should enhance the development of the financial sector. Also, the Head of the DIF, Valeriy Ogienko, announced a plan to modify the contribution scheme for commercial banks. It is planned that banks with high risk should contribute more to the DIF than safer banks. Thus, banks will have additional incentives to reduce their riskiness.

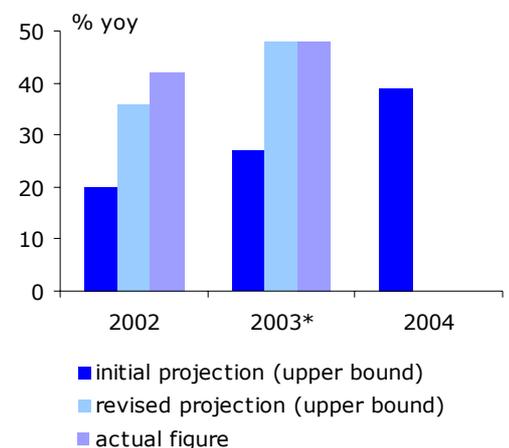
**Government debt market.** Ukraine sold an additional USD 200 m of eurobonds with a ten-year maturity and a 7.65% yield. Prime reasons of issuing eurobonds were delays with getting World Bank credits and favourable conditions on the international markets. Taking into account the relative stability in Ukrainian economic and political life, the demand for eurobonds well exceeded the proposed volume. Subject to proper debt servicing, Ukrainian eurobonds have a rather bright prospective.

### Structure of Central Budget



Sources: Law on State budget 2003, Draft Law on State budget 2004, own calculations

### Projected and Actual Growth Rates of Money Supply



\* Own estimate for actual growth rate  
Sources: NBU Council, NBU; own estimates

### Price of Ukrainian Eurobonds in 2003\*



\* Denominated in euro  
Source: Art-Capital



<b>Economic Trends</b>		<b>Q2 02</b>	<b>Q3 02</b>	<b>Q4 02</b>	<b>Q1 03</b>	<b>Q2 03</b>	<b>Jun</b>	<b>Jul</b>	<b>Aug</b>	<b>Sep</b>
GDP growth (real)	% yoy	4.7	4.3	6.1	7.9	...	8.3	-5.6	5.9	...
GDP growth (real)	% yoy cum.	4.4	4.3	4.8	7.9	7.5	7.5	5.1	5.3	...
Industrial production (real)	% yoy cum.	5.8	6.0	7.0	10.7	12.4	12.4	13.8	14.6	...
Agricultural production (real)	% yoy cum.	9.2	3.0	1.9	1.3	-6.0	-6.0	-33.5	-27.2	...
CPI	% yoy eop	-1.1	-1.1	-0.6	4.3	5.9	5.9	7.4	5.8	6.2
PPI	% yoy eop	4.0	4.9	5.7	9.9	5.3	5.3	5.3	6.8	7.4
Exports (USD)*	% yoy cum.	2.4	6.9	10.7	24.6	23.8	26.9"	28.8"	...	...
Imports (USD)*	% yoy cum.	0.9	4.7	4.9	22.8	23.3	29.0"	30.1"	...	...
Merchandise trade balance	USD bn cum.	0.20	0.37	0.98	0.32	0.29	0.44"	0.46"	...	...
Current account	USD bn cum.	1.45	2.21	3.17	1.08	1.82	x	x	x	x
Current account	% GDP	8.3	7.5	7.6	11.9	9.2	x	x	x	x
Gross international reserves	USD bn eop	3.41	4.02	4.42	4.60	6.17	6.17	6.52	...	...
Monetary Base	% yoy eop	38.0	42.9	33.6	24.4	34.2	34.2	29.3	32.0	31.0
Lending rate on UAH credits **	% pa, eop	25.0	20.1	19.5	17.9	17.2	17.2	18.2	18.2	18.1
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.33	5.33	5.33	5.33	5.33	5.33
Exchange rate (official)	EUR aop	4.88	5.24	5.33	5.71	6.05	6.23	6.07	5.95	5.97

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).

<b>Key Economic Indicators</b>		<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
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 <sup>o</sup>	1.2 <sup>oo</sup>	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

<sup>o</sup> 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

<sup>oo</sup> 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:

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