



Monthly Economic Monitor Ukraine

- Hennady Vasylyev, the former vice-speaker of Parliament and Prosecutor of the Donetsk region, became the new Prosecutor General.
- Ukraine signed a bilateral agreement with Poland on the extension of the Odesa-Brody pipeline to Plock.
- The real GDP grew by 7.2% yoy between January and October due to growth in manufacturing, trade and transport.
- The EBRD launched a project to develop private crediting against warehouse grain receipts in Ukraine.
- Ukraine signed a bilateral protocol with Israel on accession to the goods and services market within the framework of the WTO negotiation process.
- The Verkhovna Rada approved the State Budget for 2004 with revenues of UAH 60.7 bn and expenditures of UAH 64.2 bn.
- Banks experienced a temporary lack of liquidity in November.
- The NBU eased the regulations concerning trading of Ukrainian eurobonds by residents.

No.12 (38)
December
2003

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%

Politics: Hennady Vasylyev appointed new Prosecutor General

In November President Leonid Kuchma dismissed the Prosecutor General Svyatoslav Piskun, who was accused of failing to handle several notorious cases and of excessive political interference in his department. In his place Hennady Vasylyev, a member of the Party of Regions, was nominated by the President and approved by the Verkhovna Rada as the new Prosecutor General. Hennady Vasylyev previously served as the vice-speaker of Parliament and as prosecutor of the Donetsk region. Adam Martyniuk, a member of the Communist party, assumed the position of vice-speaker.

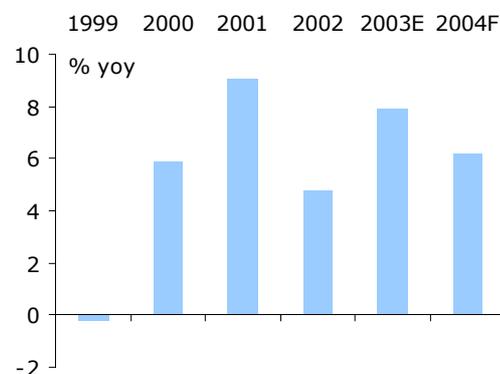
In November Ukraine signed a bilateral agreement with Poland on the construction of the Brody-Plock pipeline section, extending the existing Odesa-Brody pipeline. This confirms the intention of the Ukrainian government to transit Caspian oil from Odesa to Brody, despite strong lobbying by British Petroleum and the Russian TNK to exploit the pipeline in the reverse direction. This initiative has already received backing from the EU and Turkey. While the EU is interested in a diversification of energy sources, Turkey considers the Odesa-Brody-Plock pipeline an opportunity to reduce traffic through the Bosphorus.

In Donetsk, political opponents of Viktor Yushchenko deliberately scuttled a rally of Our Ukraine, the largest pro-reform opposition party. Similar events in Sumy, Simferopol and other regional centres, where Our Ukraine intended to hold meetings revealed that tensions within parliament could spill into the streets with socially dangerous consequences. The international community, US and EU officials once again criticized the Ukrainian authorities, representing the parliamentary majority, and urged them to insure fair elections.

Real economy: The GDP increased by 7.2% yoy from January to October

The real GDP grew by 7.2% yoy between January and October, while the nine-month growth was 6.5% yoy. This increase was caused by high growth rates of value added in manufacturing, trade and transport. Also, in October agriculture continued to recover after a collapse during the summer. The value added in agriculture declined by 13.2% yoy over the first ten months, compared to 16.7% yoy over the first nine months. The real GDP is expected to grow by 7.9% for the whole of 2003.

Real GDP Growth



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

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The most striking feature of this year's economic development is the high growth rate of investment. From January to September fixed capital investment increased by 32.5% yoy (6.2% yoy for the same period of the previous year), more than half of the increase being due to machinery and equipment purchases. This investment growth is reflected in the rapid development of machine building and construction. Specifically, construction increased by 25.1% yoy between January and September, mainly due to new constructions and repair, especially in the energy sector and in metallurgy. Housing construction lags behind last year's growth at -0.6% yoy.

Sectoral trends: The EBRD launched a project for private credits against warehouse grain receipts

Agriculture. The European Bank for Reconstruction and Development (EBRD) opened special credit lines for two Ukrainian banks to allow private credits against warehouse grain receipts. The money will be used to permit farms to take out loans based on warehouse grain receipts (i.e. claims on the grain stored in certified elevators) as credit collateral. Over the past few years the government had tried to use a similar instrument, i.e. state guaranteed grain purchases involving state lending. However, this approach was unsuccessful mainly because the government didn't provide sufficient funds for these guaranteed purchases thus failing to win the farmers' trust in state-run grain operations. Although imperfections with grain trading and state interference in the grain market restrain private credits against warehouse receipts at this time, it is expected that the EBRD loans will help to create a market for such financial services in Ukraine.

Privatisation. Approximately 90% of the Crimean Soda Plant was sold at a highly competitive auction. In total, 7 bids were submitted, 6 of which were allowed to participate, resulting in one of the highest participation rates in a privatisation contest in Ukraine. The government sold the plant to a financial company, "Kliryngoviy Dim". The selling price of UAH 346.7 m was more than twice the starting price.

Between January and September the State Property Fund received UAH 1.6 bn in privatisation revenues. This exceeded the planned amount for the period by UAH 130 m indicating a high probability of successfully completing the 2003 privatisation plan, which envisages UAH 2.2 bn of receipts. A 100% completion of a planned privatisation had never occurred as yet.

External Sector: Ukraine signed a bilateral protocol on goods and service markets accession with Israel

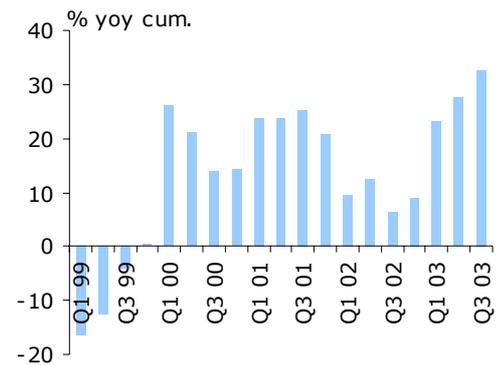
In November Ukraine took another step towards completion of the WTO negotiation process by signing a bilateral protocol with Israel on accession to the goods and services market. This is the sixteenth bilateral protocol out of 33 that Ukraine has to sign with the members of its Working Party. In addition, Ukraine has to complete multilateral talks on the harmonization of its national legislation with the WTO's requirements.

Exports of goods increased by 27.8% yoy in dollar terms between January and September, while imports surged by 32.1% yoy. The trade balance remained positive at USD 375.4 m, although this is less than it was at the same time in 2002 (USD 695.9 m) due to the faster growth of imports. Exports to Europe (excluding CIS countries) grew by 37.2% yoy, contributing most to the overall export growth. Exports to the CIS increased by 36.8% yoy, due mainly to recovery of the trade with Russia. Ukraine's imports also accelerated, especially so from Asia (67.4% yoy).

Fiscal policy: The State Budget for 2004 was approved

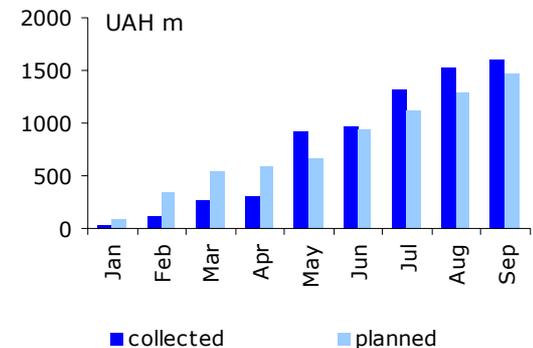
The Verkhovna Rada approved the 2004 State Budget with revenues of UAH 60.7 bn and expenditures of UAH 64.2 bn. Parliament failed however to adopt complementary changes to several tax laws.

Investment in Fixed Capital



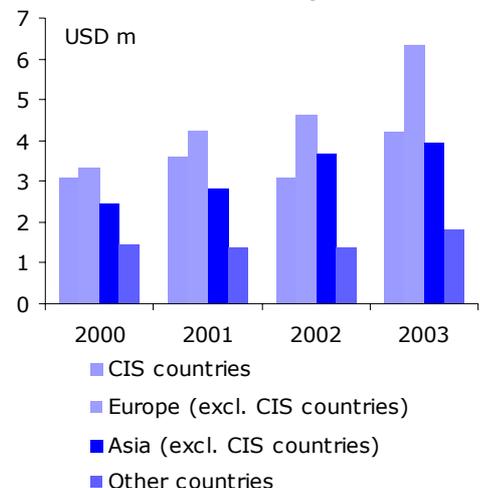
Source: Derzhkomstat

Privatisation Revenues in 2003*



Source: State Treasury
* general fund of the budget only

Regional Distribution of Merchandise Exports*



Source: Derzhkomstat
* data for January -- September of a respective year

However, some eliminating provisions were incorporated into the Law on the State Budget 2004 and became part of the revenue calculations.

The 2004 Budget assumes a minimum wage level of UAH 205 per month as of January 2004, and UAH 237 as of November 2004. Also, the 2004 Budget foresees corrections in the salary qualification ratios in the budget sector as of March 2004 in order to introduce proper incentives for high-skilled employees.

At the same time, the Verkhovna Rada approved amendments to the 2003 Budget, correcting for inconsistencies in the minimum wage assumptions. In particular, the minimum wage for December 2003 was reduced to UAH 205 from the previously assumed UAH 237.

Monetary policy: The banking system experienced a temporary lack of liquidity

In mid-November the overnight inter-bank interest rate rocketed up to 40-70% p.a. from 8-12% p.a. Two events that took place simultaneously led to serious liquidity problems in the banking system. On the one hand, a large amount of money was accumulated in the State Treasury account of the NBU, instead of being transferred to the economy through the banking system. The Minister of Finance, Mykola Azarov, announced that the accumulation of funds was caused by the inefficiency and inertia of officials in charge of budget transfers. On the other hand, a shortage of foreign currency on the foreign exchange market forced the NBU to sell international reserves, reducing the monetary base and the banks' liquidity. In order to support the banks' liquidity positions, the NBU reduced the reserve requirement ratio on demand deposits in hryvnia from 10% to 8% and eased bank access to refinancing loans, while fiscal authorities undertook steps to reduce the Treasury account balance. The joint efforts by the monetary and fiscal authorities proved successful: by the end of November the interest rate on overnight loans had fallen to the previous level. This incident once more demonstrates the utmost importance of monetary and fiscal policy coordination.

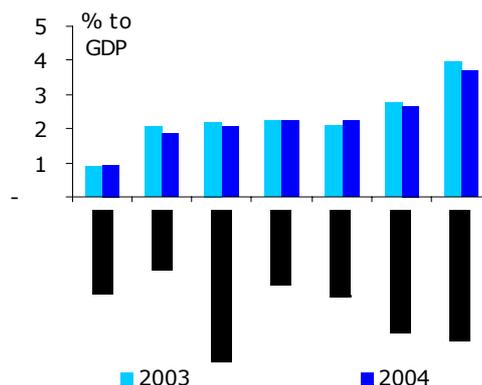
In November CPI grew by 8.1% yoy mainly due to administrative increase of bread prices, monetary base increased by 30.0% yoy.

Financial markets: Ukrainian eurobonds became more accessible for residents

Banking sector. The NBU eased the regulations concerning trading of Ukrainian eurobonds by residents starting in late November. The most important change is that residents can now sell eurobonds not only for hryvnia, but for foreign currency as well. Also, according to the NBU decree, residents need to obtain one-year license and are allowed to use only their existing foreign currency funds for buying eurobonds, purchasing currency on the inter-bank foreign exchange market in order to acquire eurobonds is not allowed. For commercial banks the maximum volume of transactions with eurobonds is limited to 10% of their assets. This relaxation of restrictions should encourage the development of capital markets, facilitate the establishment of private pension funds, and decrease the long-term cost of government debt.

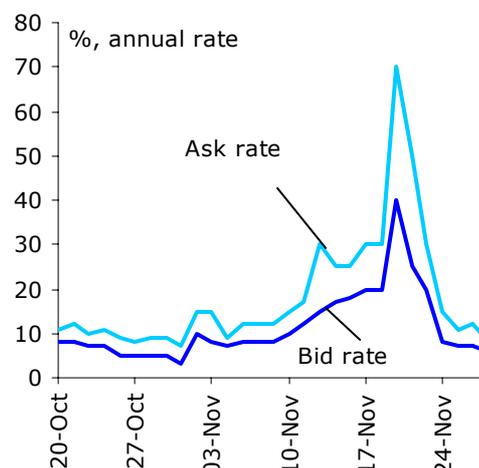
Foreign exchange. The fast depreciation of cash hryvnia against the US dollar observed over the last two months raised the concerns of NBU officials. The Governor of the NBU, Serhiy Tihipko, announced that the NBU would keep the official exchange rate constant at 5.33 UAH/USD for the rest of this year and all of next year, despite the fact that the NBU Council had planned on some slight depreciation of the hryvnia for 2004. In addition, Serhiy Tihipko announced that a 5% limit on the deviation between the official and the cash exchange rates would be reintroduced, should the hryvnia continue to depreciate on the cash market. Although the restriction was not imposed, the depreciation trend reverted in mid-November and the cash exchange market seems to have stabilized.

Planned Budget Expenditures



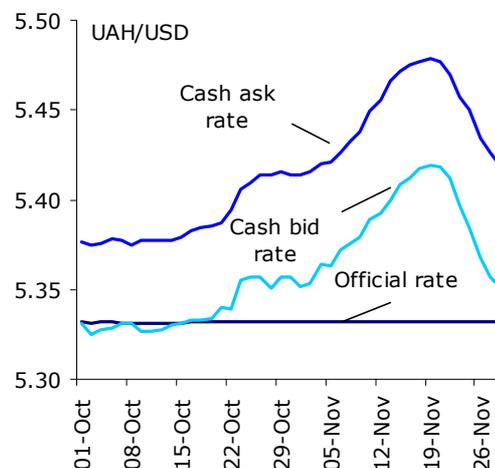
Source: State Treasury

Overnight Interbank Interest Rate Dynamics



Source: Ukrainian financial server

UAH/USD Exchange Rate Dynamics



Sources: NBU, Ukrainian financial server



Economic Trends		Q2 02	Q3 02	Q4 02	Q1 03	Q2 03	Q3 03	Aug	Sep	Oct	Nov
GDP growth (real)	% yoy	4.7	4.3	6.1	7.9	9.3	...	5.9	15.0	12.3	...
GDP growth (real)	% yoy cum.	4.4	4.3	4.8	7.9	8.6	...	5.3*	6.5*	7.2*	...
Industrial production (real)	% yoy cum.	5.8	6.0	7.0	10.7	12.4	15.2	14.6	15.2	15.7	...
Agricultural production (real)	% yoy cum.	9.2	3.0	1.9	1.3	-6.0	-16.6	-27.2	-16.6	-13.1	...
CPI	% yoy eop	-1.1	-1.1	-0.6	4.3	5.9	6.2	5.8	6.2	6.8	8.1
PPI	% yoy eop	4.0	4.9	5.7	9.9	5.3	7.4	6.8	7.4	7.9	9.4
Exports (USD)***	% yoy cum.	2.4	6.9	10.7	24.6	23.8	...	29.1''	27.8''
Imports (USD)***	% yoy cum.	0.9	4.7	4.9	22.8	23.3	...	31.2''	32.1''
Merchandise trade balance	USD bn cum.	0.20	0.37	0.98	0.32	0.29	...	0.40''	0.38''
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	6.68	6.85	6.68	6.89'	6.91'
Monetary Base	% yoy eop	38.0	42.9	33.6	24.4	34.2	31.0	32.0	31.0	30.7	30.0
Lending rate on UAH credits **	% pa, eop	25.0	20.1	19.5	17.9	17.2	18.1	18.2	18.1	17.8	18.0
Exchange rate (official)	USD aop	5.33	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	6.00	5.95	5.97	6.23	6.23

SOURCES: Derzhkomstat, Ministry of Finance, NBU, IFS, own calculations

' Own estimate based on net international reserves reported by the NBU

" Monthly figures are only for merchandise exports and imports (source: Derzhkomstat).

Quarterly figures are for trade in goods and services (source: NBU).

* Monthly figures do not include the regular quarterly revision of the GDP series

**Weighted average for different maturities (source: NBU).

*** Growth rate in dollar terms.

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	170.1	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 ^o	1.2 ^{oo}	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

^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