

Monthly Economic Monitor Ukraine

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- Changes to the Constitution intended to change the balance of power in Ukraine were adopted in first reading.
- The Constitutional Court ruled that Leonid Kuchma has the right to be a candidate in the 2004 presidential elections.
- The real GDP grew by 7.7% yoy between January and November.
- The State Property Fund reached its annual privatisation revenue target of UAH 2.15 bn in 2003.
- Ukraine signed protocols on access to goods and services markets within the framework of the WTO accession negotiations with Brazil, Poland, Estonia and Thailand.
- The Government approved the issuance conditions for VAT refund debt bonds.
- Inflation reached by 8.2% yoy in 2003.

Politics: Changes to the Constitution passed first reading

On December 24 the Verkhovna Rada gave preliminary approval to the draft law on amendments to the Constitution, which was introduced by deputies of the pro-presidential majority. The bill was supported by 276 votes, with 226 needed. Deputies from the opposition factions "Our Ukraine", "Socialist Party of Ukraine" and the "Yulia Tymoshenko Bloc" tried to halt the work of Parliament not to let the voting proceed. The Communist party of Ukraine joined the pro-presidential majority in the vote. This law is meant to change the balance of power in Ukraine by strengthening the Cabinet of Ministers and Parliament, and by taking away certain presidential prerogatives. However, the main point of discord is the transition clauses, which provide for election of the President by Parliament and not by a direct vote. Another concern is that the President elected in 2004 by direct vote would rest in the office for year and a half and after that a new president is supposed to be elected by Parliament. For the bill to enter into force it will be necessary to attract 300 votes in the Spring 2004 session.

The Constitutional Court of Ukraine has passed judgment on the question whether the current president, Leonid Kuchma, could stand as a candidate in the 2004 elections. The Court ruled that Mr. Kuchma has the right to be a candidate in 2004. The Constitution of Ukraine prohibits the same person to occupy the presidential office more than twice. The current president, Leonid Kuchma, was elected president two times in a row, first in 1994 and then in 1999. However, the current Constitution was passed in 1996, i.e. after his first election. Thus, technically, Mr. Kuchma has been elected president only once under the current constitution, which was the main reasoning of the Constitutional Court in support of its decision. The decision raised strong criticism from opposition politicians and social leaders, who called it unjustified and absurd.

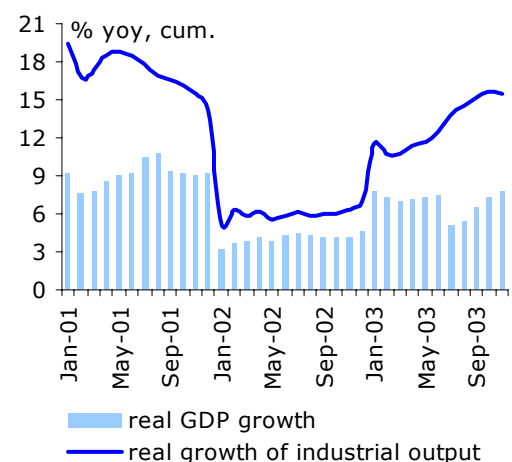
In December the presidents of Ukraine and Russia signed the "Agreement on using the Azov Sea and the Kerch Strait", which needs to be ratified by the two parliaments. The agreement states that the Azov Sea and the Kerch Strait are historically internal waters of both countries. Future passages of military ships of third countries through these waters will need the agreements of both Russia and Ukraine. The borders will be defined in a future treaty.

Real economy: The GDP continues to grow

Between January and November the real GDP increased by 7.7% yoy compared to a 4.1% yoy rise over the same period the year before. The fast growth of value added in manufacturing, construction, trade and transport caused this economic development. Agriculture still

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%

GDP and Industrial Output



Source: Derzhkomstat

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remained the major sector slowing down overall GDP growth: the value added in this sector decreased by 11.9% yoy.

Backed by high internal and external demand, industrial output grew by 15.8% yoy during the first eleven months of the year. In particular, machine building increased by 34.2% yoy (mainly due to increased transport equipment production) reflecting a growing internal investment demand. The favourable situation on the world metal markets caused a 13.6% yoy rise in the metallurgy output.

Sectoral trends: The privatisation revenue target was achieved

Privatisation. The State Property Fund (SPF) reached its annual privatisation revenue target of UAH 2.15 bn in 2003, a unique achievement for the last several years. During the year the SPF successfully privatised several large enterprises, such as the mobile operator UMC and the Nikopol Ferroalloys plant. Budget-2004 envisages privatisation revenues of UAH 2.14 bn. This target is likely to be reached if the political situation remains favourable.

In a competition against leading foreign companies, the Ukrainian corporation Industrial Union of Donbas together with the multinational company Duferco succeeded in acquiring 79.48% of the state-owned shares of the largest Hungarian steel mill Dunaferr, having offered near EUR 400 m of investment obligations. This purchase is expected to become Ukrainian largest investment project abroad since independence.

The Industrial Union of Donbas has also won the privatisation tender for the Ukrainian state-owned 98.81% share of the Dniprovskiy Metallurgical mill Dzerzhinskogo. Its single competitor Pryvat Intertrading was not allowed to participate due to incomplete disclosure of its financial situation and losses last year. In addition to investment obligations of UAH 1 bn, due before the end of 2008, the winner offered UAH 710 m as a privatisation bid. However, in line with Ukrainian legislation concerning privatisation auctions with a single participant, the final price will be determined by an independent appraiser.

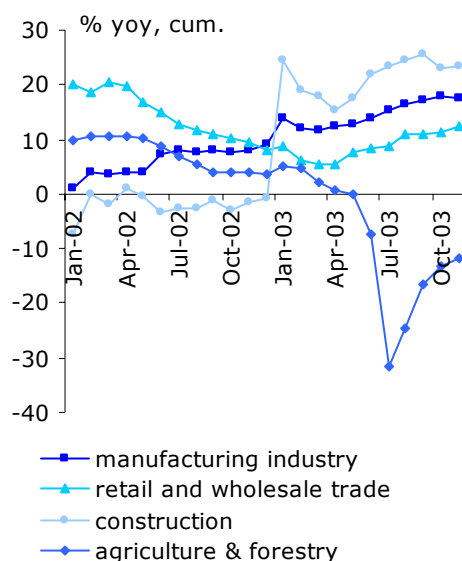
Agriculture. At the 32nd session of the conference of the United Nations Food and Agricultural Organisation (FAO) Ukraine became a member of this organisation. Since the FAO aims at enhancing living standards and solving the world food problem, Ukraine as a member state will have to take part in combating world hunger. In turn, FAO membership will help Ukraine to speed up agricultural reform, improve farm efficiency and the welfare of its rural residents.

External Sector: Ukraine signed several bilateral protocols within the framework of WTO accession

In December Ukraine signed four protocols on access to goods and services markets within the framework of the WTO accession negotiations: with Brazil, Poland, Estonia, and Thailand. As of now Ukraine has signed 20 bilateral protocols, eleven of which were signed in 2003. Among the remaining countries intending to sign bilateral protocols with Ukraine, the USA raises the major concern. The main questions in the negotiations with the USA relate to taxation, the activities of the special economic zones, intellectual property rights, sanitary and phytosanitary measures, and technical barriers in trade.

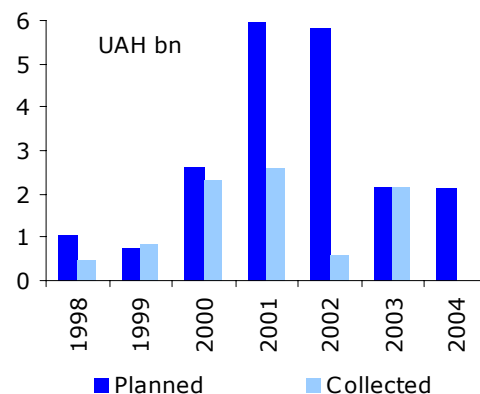
The NBU reported a current account surplus of USD 2.5 bn in the first nine months of 2003, that is 12.8% higher than in the respective period of the previous year. At the same time, the balance of goods amounted to USD 124 m (USD 485 m in the respective period of 2002) due to a higher growth rate of imports as compared to exports. The inflow of foreign direct investments (FDI) amounted to USD 935 m, increasing 2.4 times over the FDI inflow from January to September 2002. Since independence Ukraine received nearly USD 6.9 bn of FDI or approximately USD 144 per capita.

Growth of Value Added in Selected Sectors



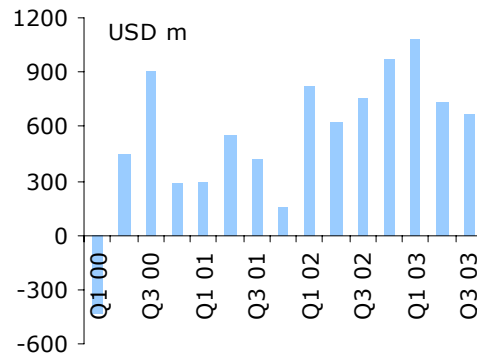
Source: Derzhkomstat

Privatisation Revenues



Source: State Treasury

Current Account Balance



Source: NBU

Fiscal policy: The government tries to solve the VAT refund problem

In line with the 2004 State Budget, the Government has approved the conditions issue and circulation of VAT refund debt bonds, which will be used to compensate for overdue government liabilities. The bonds will have a face value of UAH 1000 and mature in five years. They will be amortized annually and offer an annual interest of 1.2 times the NBU refinancing rate (currently 7% p.a.). The whole value of the issue will be UAH 1.9 bn, although the existing overdue refund debt is estimated at around UAH 4.0 bn. Though a positive development towards solving the VAT refund problem, this debt conversion is only a partial remedy, since it does not address the possibility of future debt accumulation.

One of the most hotly debated issues in December was the provision in the 2004 State Budget, which eliminates VAT privileges for all medicines excluding those named in a special list of the Cabinet of Ministers. Taking into account the social consequences of higher prices for medicines, the Cabinet adopted a list basically including all medicines except so-called "medical luxuries". The Government claims the exclusion of these items will allow collecting an additional UAH 500 m in VAT revenues, which seems to be an overestimate.

For the first eleven months of 2003 the central fiscal revenues exceeded 100% of plan. The expenditures execution rate was close to 94%, due to under-execution of all budgeted items. The central fiscal surplus reached UAH 2.3 bn.

Monetary policy: The inflation rate reached 8.2%

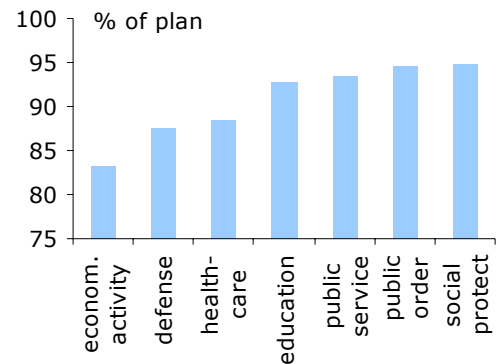
By the end of 2003 the monetary base increased by 30.1% yoy, while the money supply grew by 47.2% yoy, which is close to the NBU's revised projection. At the same time consumer prices grew by 8.2% yoy, mainly due to higher prices for food products. The Governor of the NBU, Sergiy Tihipko, expressed some concern about the higher than expected dynamics of consumer prices in 2003. He announced that the NBU is going to restrict the growth of the money supply during the first quarter of 2004 in order to prevent further inflation. Next year's inflation is forecast to reach 6.6% yoy.

Despite the fact that the inflation continues to exceed the refinancing rate, the NBU kept its rate at the level of 7% p.a. making the real interest rate negative. According to current legislation, the refinancing rate serves "as a value of money in the economy" and is supposed to be kept at a positive level with respect to inflation. The unwillingness of the NBU to increase the refinancing rate is most likely caused by a desire to avoid breaking the downward trend followed since the crisis of 1998, which could give the commercial banks a negative signal and in turn might induce them to raise interest rates on bank loans and deposits.

Financial markets: The banking sector performance has improved

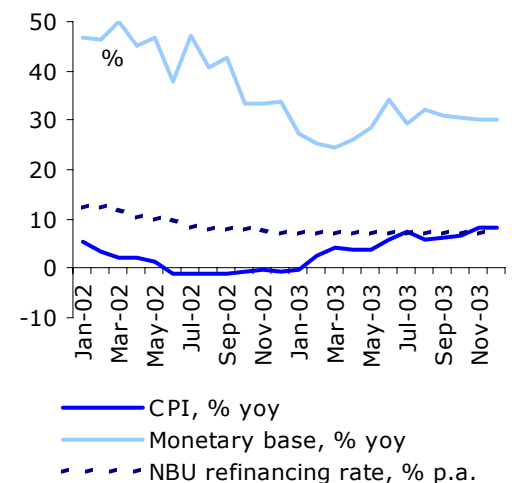
Banking sector. According to the NBU, the commercial banks in 2003 earned profits of UAH 968 m, which is 42% higher than in 2002. Last year the banking sector also performed better in terms of efficiency: the return on capital grew from 8% to 9%, while the return on assets remained almost unchanged at 1.2%. As before, interest earnings continue to be the main source of revenues in the banking sector providing nearly 70% of total revenues. The distinctive feature in last year's development in the banking sector is rapidly increasing households crediting. The share of loans granted to households in the total volume of bank credits grew to above 11% (from 7% at the end of 2002). While this figure is still quite low, the growing trend signals that the role of the banks in stimulating the private consumption of durable goods is becoming more important. The total credit portfolio of the commercial banks increased by 70% yoy, constituting about UAH 68 bn by the end of the year.

Execution of Central Fiscal Expenditures



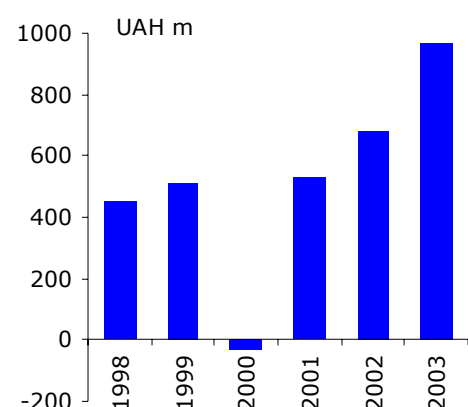
Source: State Treasury

CPI, Monetary Base, and Refinancing Rate



Source: Derzhkomstat, NBU

Banking Sector Profits



Source: NBU



Economic Trends		Q3 02	Q4 02	Q1 03	Q2 03	Q3 03	Sep	Oct	Nov	Dec
GDP growth (real)	% yoy	4.3	6.1	7.9	9.3	...	15.0	12.3	12.1	...
GDP growth (real)	% yoy cum.	4.3	4.8	7.9	8.6	...	6.5*	7.2*	7.7*	...
Industrial production (real)	% yoy cum.	6.0	7.0	10.7	12.4	15.2	15.2	15.7	15.5	...
Agricultural production (real)	% yoy cum.	3.0	1.2	1.3	-6.0	-16.6	-16.6	-13.1	-12.3	...
CPI	% yoy eop	-1.1	-0.6	4.3	5.9	6.2	6.2	6.8	8.1	8.2
PPI	% yoy eop	4.9	5.7	9.9	5.3	7.4	7.4	7.9	9.4	11.1
Exports (USD)***	% yoy cum.	6.9	10.7	24.6	23.8	23.7	27.8"	27.7"
Imports (USD)***	% yoy cum.	4.7	4.9	22.8	23.3	25.1	32.1"	32.9"
Merchandise trade balance	USD bn cum.	0.37	0.98	0.32	0.29	0.12	0.38"	0.31"
Current account	USD bn cum.	2.21	3.17	1.08	1.82	2.49	x	x	x	x
Current account	% GDP	7.5	7.7	11.9	9.2	10.4	x	x	x	x
Gross international reserves	USD bn eop	4.02	4.42	4.60	6.17	6.68	6.68	6.88	6.94'	6.90'
Monetary Base	% yoy eop	42.9	33.6	24.4	34.2	31.0	31.0	30.7	30.0	30.2
Lending rate on UAH credits **	% pa, eop	20.1	19.5	17.9	17.2	18.1	18.1	17.8	18.0	17.9
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	5.24	5.33	5.71	6.05	6.00	5.97	6.23	6.23	6.54

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	31.2	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	13.2	14.2	7.0
Agricultural production	% yoy	-3.6	-9.5	-1.9	-9.6	-6.9	9.8	10.2	1.2
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	15.7	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	7.7
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	45.2	36.3	34.3
External debt (total)	% GDP eop	26.3	20.5	19.4	38.4	49.9	33.0	26.0	24.6
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