

# Monthly Economic Monitor Ukraine

- The FATF removed Ukraine from the blacklist of non-cooperating countries.
- The Government decided to use the Odessa-Brody oil pipeline in the westward direction.
- The Verkhovna Rada dropped the requirement to elect the President by Parliament from the constitutional reform draft law.
- The privatisation revenues collected in January and February constitute one third of this year's target.
- The trade surplus for goods decreased significantly in 2003, while the balance of services maintained its high surplus.
- Central fiscal revenues were executed at 100.7% of plan in January, while expenditures were at 65% of the targeted level.
- Ukraine issued USD 600 m worth of eurobonds with a seven-year maturity and a 6.9% yield.

**No.3 (41)  
March  
2004**

**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: Ukraine is excluded from the FATF blacklist

On February 25 the Financial Action Task Force (FATF) removed Ukraine from the blacklist of countries and territories, which are not cooperative in the fight against money laundering. The FATF expressed satisfaction with Ukraine's progress in enacting anti-money-laundering legislation and in creating a sound financial monitoring system. This decision will facilitate the processing of international transactions by Ukrainian residents. More importantly, this action will improve the image of Ukraine in the world.

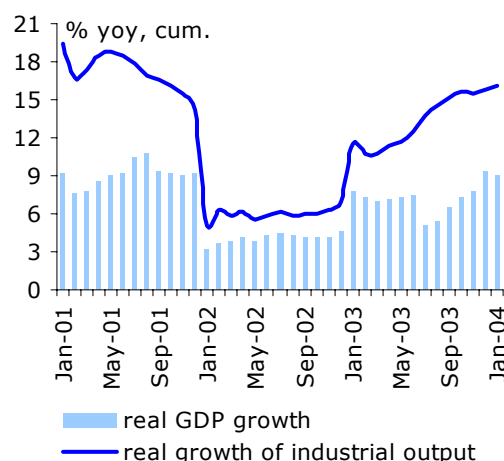
The Government approved the decision to use the Odessa-Brody oil pipeline for pumping Caspian oil to European consumers. Prior to that decision the trans-national corporation TNK-BP had made an offer to use the pipeline to pump Russian oil in the opposite direction – from Brody to Odessa. After considering the two scenarios, the government chose to use the pipeline in the European direction. Currently, intense negotiations are taking place between Ukraine, potential private consumers and suppliers of Caspian oil with a view to putting the pipeline to work as soon as possible. Furthermore, negotiations with international financial organisation are under way to raise the money necessary to extend the pipeline to Ploch.

The Verkhovna Rada has adopted changes to the constitution reform draft law by removing the requirement to elect the President by Parliament. With only 226 votes necessary for adoption of this change, a wide majority of 304 deputies, including deputies from the Communist and Socialist parties, supported the changes. These amendments removed the deadlock in the negotiations, and the constitutional reform has now a better chance of being completed. The main idea of the constitutional reform is to curtail the power of the President and increase the power of Parliament, thus transforming Ukraine into a parliamentary-presidential republic.

## Real economy: The trends of 2003 continue

In January the real GDP increased by 9.0% yoy. The highest growths of value added were registered in manufacturing and construction, while the value added in agriculture declined by 4.2% yoy, maintaining the 2003 tendencies. The industrial output grew by 16.1% yoy. Same as last year, the highest growth was in machine building (39.8% yoy), mainly due to an exceptional increase in transport equipment production. The persistence of high growth rates in construction and machine building suggests that investment demand growth continues in the first quarter of 2004.

**GDP and Industrial Output**



Source: Derzhkomstat

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### Sectoral trends: The privatisation revenues for January-February represent one third of this year's target

**Privatisation.** The State Property Fund (SPF) has already received UAH 767 m of privatisation receipts, which constitutes one third of the privatisation revenue target for this year. This happened because the privatisation contract amount for the Dzerzhinskogo metallurgical works sold in 2003 was transferred. At the same time, the attempt to privatise a 92% share in Pavlogradvugillya at a starting price of UAH 1.3 bn failed because the only bidder did not pay the required guarantee fee.

The SPF has compiled a register of state corporate ownerships. According to this register, the state owns shares in 1517 enterprises, with total assets of UAH 34 bn. The SPF manages most Ukrainian state corporate rights, while the Cabinet of Ministers directly manages the stakes in 21 holding companies. This new register is likely to improve state supervision of all partially state-owned enterprises, thus preventing misuses of power by the management of these firms.

**Infrastructure.** The Board of Supervisory Council appointed a new Acting Chairman of the Board for Ukrtelecom. This appointment becomes the culmination of the long-standing dispute between Ukrtelecom's management and the SPF concerning the date of the shareholders meeting. The change in the management could also influence the sale of the 42.86% stake scheduled for the second half of 2004. Meanwhile, several telecommunication companies, including the Russian Sviazinvest and Sistema Telecom, the Norwegian Telenor, Deutsche Telecom, and the Turkish Cukurova Holding, openly or implicitly declared an interest in the privatisation.

**Agriculture.** According to Derzhkomstat, half of all agricultural enterprises declared profits in 2003, while in 2002 the share of profitable enterprises was 46%. A possible explanation for this increase in the number of profitable enterprises is that higher grain prices compensated for yield losses in 2003.

### External Sector: Ukraine signed a bilateral protocol with Switzerland

In February Ukraine and Switzerland signed a bilateral protocol on access to markets of goods and services within the framework of the WTO accession. Since Switzerland is known for its active promotion of trade liberalisation, the success of the negotiations with this country may facilitate negotiations with the remaining member-countries of Ukraine's Working Party, such as the USA, Japan, China, Turkey, and Lithuania.

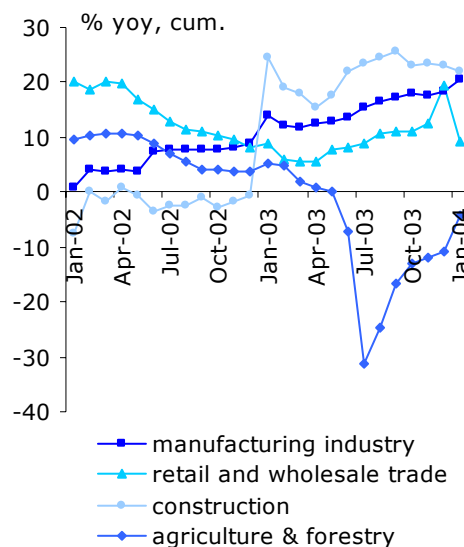
According to Derzhkomstat, the export of goods increased by 28.5% in dollar terms in 2003, while imports grew by 35.6%. Higher aggregate domestic demand induced the inflow of energy and investment goods. As a result, the trade surplus of goods reduced to USD 60 m in 2003 from almost USD 1 bn in the previous year. However, according to Derzhkomstat, Ukraine had a high positive balance of services at the level of USD 2859.6 m, which allowed it to maintain a high current account surplus.

The Government intensified its intervention in foreign trade through non-tariff measures. In February the customs registration of export contracts for selected nonferrous metals was suspended. The reason behind this decision was to cover the deficit of nonferrous metals on the domestic market. It is expected that exports may resume in the spring after the mechanism of export contracts registration will be developed. These actions exhibit a tendency to use non-market instruments of economic policy.

### Fiscal policy: Revenues and expenditures follow last year trend

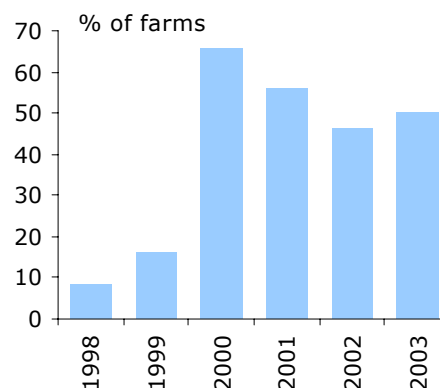
In January the central fiscal revenues were 0.7% higher than projected due to good VAT collections, excises and import duty

Growth of Value Added in Selected Sectors



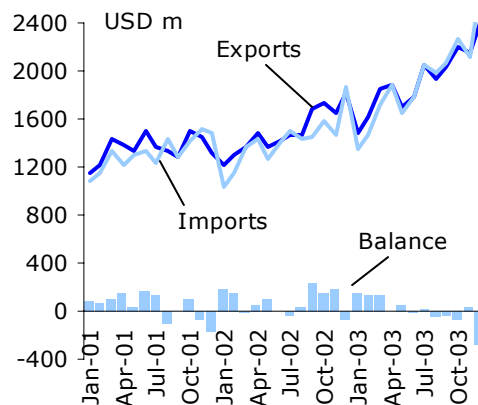
Source: Derzhkomstat

Profitable Farms



Source: Derzhkomstat

Merchandise Trade



Source: Derzhkomstat



revenues. Revenues from the enterprise profit tax fell 27% below projections. The fiscal expenditures were at 65% of the targeted level. This repeats the situation of previous years when expenditures were postponed to future periods.

The Verkhovna Rada has adopted changes to several taxation laws that complement the Law on the State Budget 2004. These changes partially restore VAT privileges, which were suspended in Budget 2004 (e.g. for printed mass-media), and also renew VAT refunds to agricultural exporters. The overall effect on fiscal revenues is expected to be neutral due to increases in excise taxes on gasoline and cigarettes, as well as state duties and gambling license fees. In addition, the Law foresees a reduction of the VAT rate to 17% starting in 2005 and further down to 15% in 2006. The Law also introduces an automatic system of VAT reimbursement (i.e. not requiring prior approval from the State Tax Administration), which should have a positive effect on the long-standing problem of VAT refund arrears accumulations. To come into effect the Law has to be signed by the President.

**Monetary policy: The NBU introduces money contraction measures**

In February the NBU adopted several decisions, which will affect the liquidity positions of all banks. First, the banks' demands for liquid resources are likely to increase since the NBU prohibited to cover part of the bank's required reserves by their vault cash. At the same time, starting in March, the NBU somewhat restricted the conditions for refinancing loans, while introducing new instruments for collateral. In addition, central bank loans became more expensive since the NBU again increased its overnight ("lombard") rate from 8.5 to 8.7% p.a. Separately these measures might not have any significant effect on a bank's liquidity position, but together they may well create an upward pressure on the interbank interest rate and, hence on other bank rates. These steps of the monetary authorities could be considered as being designed to restrict monetary expansion. In February monetary base grew by 34.6% yoy, while money supply increased by 47.8% yoy.

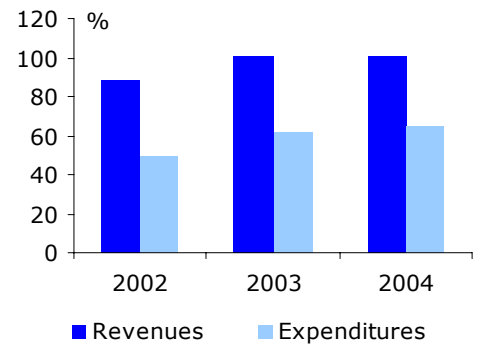
The growth of consumer prices continued to decelerate reaching 7.4% yoy in February. However, the government is becoming concerned with the quite rapid increase in producer prices (14.9% yoy) and has proclaimed its intention to intervene in the price formation mechanisms, specifically on the construction materials and metals markets. Although such a policy may be temporarily successful in suppressing inflation, it most probably will contribute to an even more rapid price growth after the presidential election.

**Financial markets: Ukraine sold USD 600 m eurobonds**

**Government debt market** At the end of February Ukraine successfully sold USD 600 m of eurobonds with a seven-year maturity and a 6.9% yield. This is the lowest yield for Ukraine's eurobonds ever. The main reason for this is the propitious timing of the issue: removal of Ukraine from the FATF blacklist and the country's good economic performance in 2003. The rating agency Fitch assigned a B+ rating with stable outlook to this issue.

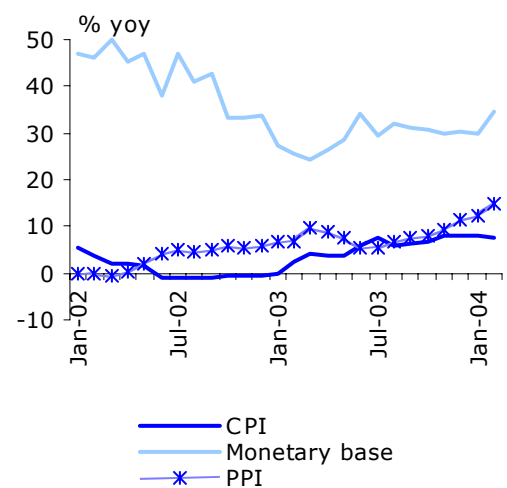
According to a new regulation, adopted by the Ministry of Finance, the purchase volumes of domestic government bonds (OVDP) by non-residents will be restricted. A special committee, consisting of NBU and Ministry of Finance representatives, will set the maximum volume non-residents can buy. Under the current situation - domestic government bonds not being very attractive since their yields do not correspond to the risk - this restriction seems to be unnecessary.

**Central Fiscal Execution in January**



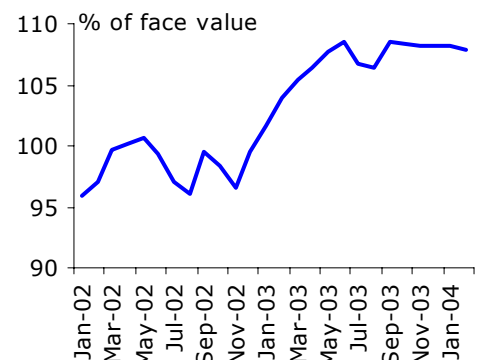
Source: Treasury reports

**Prices and Monetary Base**



Source: Derzhkomstat, NBU

**Price of Ukrainian Eurobonds in 2002-2004\***



\* Denominated in euro

Source: Art-Capital and Frankfurt Stock Exchange



<b>Economic Trends</b>		<b>Q4 02</b>	<b>Q1 03</b>	<b>Q2 03</b>	<b>Q3 03</b>	<b>Q4 03</b>	<b>Nov</b>	<b>Dec</b>	<b>Jan</b>	<b>Feb</b>
GDP growth (real)	% yoy	6.1	7.9	9.3	...	...	12.1	...	9.0	...
GDP growth (real)	% yoy cum.	5.2	7.9	8.6	7.8	9.3	7.7*	8.5*	9.0*	...
Industrial production (real)	% yoy cum.	7.0	10.7	12.4	15.2	15.8	15.5	15.8	16.1	...
Agricultural production (real)	% yoy cum.	1.2	1.3	-6.0	-16.6	-10.2	-12.3	-10.2	-6.4	...
CPI	% yoy eop	-0.6	4.3	5.9	6.2	8.2	8.1	8.2	8.1	7.4
PPI	% yoy eop	5.7	9.9	5.3	7.4	11.1	9.4	11.1	12.4	14.9
Exports (USD)**	% yoy cum.	10.7	24.6	23.8	23.7	...	27.9"	28.5"	...	...
Imports (USD)**	% yoy cum.	4.9	22.8	23.3	25.1	...	33.6"	35.6"	...	...
Merchandise trade balance	USD bn cum.	0.98	0.32	0.29	0.12	...	0.34"	0.06"	...	...
Current account	USD bn cum.	3.17	1.08	1.82	2.49	...	x	x	x	x
Current account	% GDP	7.7	11.9	9.2	7.5	...	x	x	x	x
Gross international reserves	USD bn eop	4.42	4.60	6.17	6.68	...	6.95	6.94	7.04'	7.62'
Monetary Base	% yoy eop	33.6	24.4	34.2	31.0	30.2	30.0	30.2	30.0	34.6
Lending rate on UAH credits **	% pa, eop	19.5	17.9	17.2	18.1	17.9	18.0	17.9	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
Exchange rate (official)	EUR aop	5.33	5.71	6.05	6.00	6.34	6.23	6.54	6.73	6.74

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.

<b>Key Economic Indicators</b>		<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
Nominal GDP	UAH bn	81.5	93.4	102.6	130.4	170.1	204.2	225.8	263.2
Nominal GDP	USD bn	44.6	50.2	41.9	31.6	31.2	37.8	42.6	49.4
GDP growth (real)	% yoy	-10.0	-3.0	-1.9	-0.2	5.9	9.2	5.2	9.3
Industrial production	% yoy	-5.1	-0.3	-1.0	4.0	13.2	14.2	7.0	15.8
Agricultural production	% yoy	-9.5	-1.9	-9.6	-6.9	9.8	10.2	1.2	-10.2
CPI	% yoy aop	80.2	15.9	10.6	22.7	28.2	12.0	0.8	5.2
CPI	% yoy eop	39.7	10.1	20.0	19.2	25.8	6.1	-0.6	8.2
PPI	% yoy aop	52.1	7.7	13.2	31.5	20.9	8.6	3.1	7.8
PPI	% yoy eop	17.3	5.0	35.4	15.7	20.8	0.9	5.7	11.2
Exports (gs, USD)	% yoy	19.1	0.0	-13.4	-7.9	17.9	9.5	10.7	...
Imports (gs, USD)	% yoy	17.4	2.0	-14.0	-19.1	18.9	14.1	4.9	...
Current account	USD bn	-1.2	-1.3	-1.3	0.9 °	1.2 °°	1.4	3.1	...
Current account	% GDP	-2.7	-2.7	-3.1	2.9 °	3.8 °°	3.7	7.7	...
FDI (net)	USD bn	0.5	0.6	0.7	0.5	0.6	0.8	0.7	...
International reserves	USD bn	1.97	2.36	0.79	1.09	1.48	3.09	4.42	6.94
Fiscal balance'''	% GDP	-5.1	-6.8	-2.7	-2.1	-0.7	-1.9	0.8	-0.2
Total state debt	% GDP eop	25.0	30.3	49.4	61.4	45.2	36.3	34.3	29.5
External debt (total)	% GDP eop	20.5	19.4	38.4	49.9	33.0	26.0	24.6	17.3
Monetary base	% yoy eop	38.0	44.6	21.9	39.3	39.9	37.4	33.6	34.6
Exchange rate	USD aop	1.83	1.86	2.45	4.13	5.44	5.37	5.33	5.33
Exchange rate	USD eop	1.88	1.90	3.43	5.07	5.44	5.30	5.33	5.33
Exchange rate	EUR aop	2.32	2.11	2.77	4.39	5.03	4.81	5.03	6.02
Exchange rate	EUR eop	2.36	2.11	4.02	5.20	5.10	4.67	5.53	6.66

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

''' "Minus" denotes a consolidated fiscal 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:

<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