



Monthly Economic Monitor Ukraine

- The Verkhovna Rada adopted a law that introduces a proportional party-list approach for parliamentary elections.
- The IMF approved a USD 605 m stand-by arrangement for Ukraine.
- Agricultural producers, who export themselves, are eligible for VAT refunds.
- The net inflow of FDI doubled, reaching USD 1.4 bn in 2003.
- Special VAT accounts are to be introduced in May.
- The NBU takes steps to enhance its control over bank liquidity.
- The bank's regulative capital adequacy requirement ratio was raised from 8% to 10%.

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2004

Population: 48 m

Industry/GDP: 28.8%

Agriculture/GDP: 10.9%

Investment/GDP: 19.14

Export destinations: Russia 17%, EU 20%

Import origins: Russia 35%, EU 23%

Politics: The Verkhovna Rada voted for a proportional party-list approach to parliamentary elections

In March the Verkhovna Rada adopted the law "On Elections of People's Deputies of Ukraine". The law was approved by 255 members, while the opposition factions Our Ukraine and the Yulia Tymoshenko Bloc abstained from voting. The law introduces a purely proportional party-list approach for parliamentary elections, invalidating the present system whereby 50% of the mandates were based on party lists and 50% were chosen by direct vote. To be represented in Parliament, a party or block must now get at least 3% of the votes instead of the current 4%. This new election system was a condition imposed by the Communist and Socialist parties for their support of the constitutional reforms advocated by the pro-presidential parliamentary majority. Signed by the President, this law removes virtually all obstacles for the constitutional reform.

After long negotiations the IMF finally approved a 12-months Precautionary Stand-By Arrangement for Ukraine. Despite Ukraine's very good economic performance, approval of the loan had been postponed several times because of the IMF's concerns about VAT refund arrears and certain VAT privileges. Ukraine's progress in solving these problems, such as the introduction of VAT bonds, satisfied the IMF board and allowed Ukraine to receive USD 605 m for supporting its position in case of balance of payment problems. The arrangement foresees no immediate transfer of funds to Ukraine, but only upon a request from Ukrainian authorities. Taking into account that Ukraine has accumulated a solid stock of international reserves and that there are no grounds to expect serious problems with the balance of payment in the near future, the major benefit of this arrangement is one of enhancing Ukraine's image in the opinion of the international economic community.

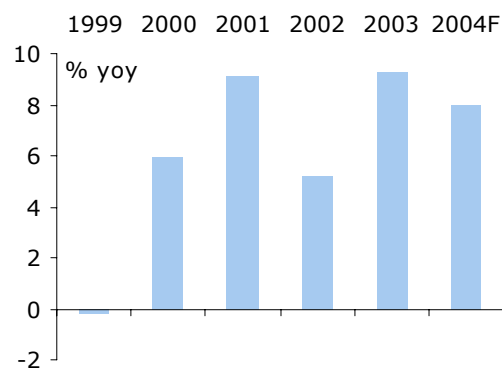
Prime-Minister Viktor Yanukovich reported to parliament on the implementation of the "Openness - Actions - Results" program of the Cabinet of Ministers. He also submitted a new program called "Consistency - Effectiveness - Responsibility" for approval. The new program was adopted by 239 votes.

Real economy: The GDP growth accelerates

The real GDP increased by 10.2% yoy between January and February 2004, backed by growth in all sectors of the economy except for agriculture and the production and distribution of electricity, gas, and water. Industrial output increased by 18.2% yoy compared to an 11.1% yoy rise during the same period in 2003. Among the industrial sectors machine building grew the most, reaching 38.0% yoy. Transport equipment production especially accelerated due to mounting domestic demand and exports.

Derzhkomstat revised its estimate of the real GDP growth in 2003 upwards to 9.4% from the previous 8.5%. The growth was caused by

Real GDP Growth



Source: Derzhkomstat
F -- Government target forecast

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the expansion of both domestic and external demand. According to up-dated information, the final consumption of households increased by 12.4%, mainly due to an enormous acceleration of non-food consumption, like spending on health care, education, transport, and communication. Although decelerating in the last quarter, gross fixed capital accumulation grew by 15.8% in 2003 contributing near one third to the total GDP growth.

Sectoral trends: Agricultural producers, who are exporting themselves, are eligible for the VAT refund

Agriculture. The President signed the law on amendments to the State Budget 2004, which among other items envisage VAT reimbursement to exporters of food products and agricultural commodities, except for rye, barley and wheat. Likely, the VAT will be reimbursed only to those exporters who produce the commodities themselves, while traders, who export most Ukrainian agricultural commodities, are not eligible for the VAT refund. If applied, such provision is likely to impede agricultural exports in 2004 because of increased transaction costs.

According to the Ministry of Agrarian Policy, the grain harvest is forecast at 32-35 m tons in 2004, compared to the 20.2 m tons harvested in 2003. As expected, the food grain harvest will be more than sufficient to cover the domestic requirements for food grains, which stand at 6-7 m tons, thus, a food crisis similar to last year's is very unlikely to repeat.

Infrastructure. The result of a recent road-show for the national telecommunications operator, Ukrtelecom, revealed that its privatisation in 2004 is rather unlikely due to the absence of an independent regulatory authority, the ban to switch off some privileged customers, and the present unstable political situation in the country prior to elections.

Privatisation. As of the end of March privatisation receipts were UAH 914 m, or 42% of the annual projection. The Head of the State Property Fund (SPF), Mykhaylo Chechetov, expects that the SPF will manage to collect 30-40% more than targeted for this year. This is a rather realistic estimate given that the list of possible offers includes such large and attractive enterprises as Pavlogradvuhillya, the large coal-mining enterprise, and the Odessa State Port Plant.

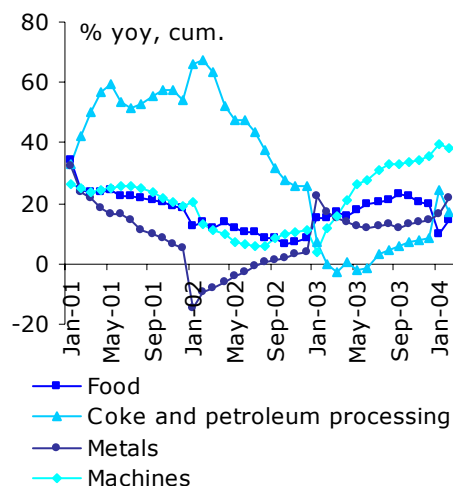
External Sector: The net FDI inflow doubled in 2003

The most important feature in the balance of payment in 2003 was an accelerated FDI inflow into the economy. The net FDI inflow was USD 1.4 bn; double that of a year ago. Since 1991 the total amount of FDI reached USD 7.0 bn, or approximately USD 150 per capita. Although the higher inflow may signify an improved perception by foreign investors of Ukraine's investment climate, the level of investment still remains significantly lower than in most other transition economies.

According to the NBU, due to the positive balance of services and the continued inflow of current transfers the current account balance remained positive at USD 2.9 bn in 2003, though lower than the USD 3.2 bn in the year before. Noteworthy in last year's trade picture was a negative balance of goods reaching USD 269 m due to high import growth (33.7% yoy), which exceeded that of exports (27.2% yoy).

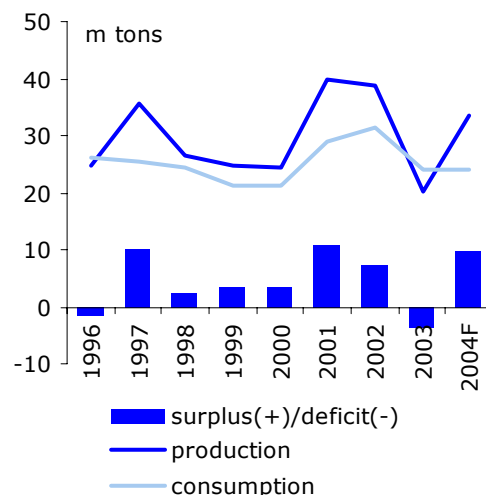
According to Derzhkomstat, exports of goods increased by 43.0% yoy in dollar terms in January 2004, while imports grew by 28.7% yoy. The balance of trade was positive at USD 393.8 m. The decline in exports of agricultural products was more than compensated by higher exports of mineral products, chemicals, metal products, machinery, transport, and equipment. The structure of imports remained similar to 2003, dominated by raw materials, intermediate inputs and investment goods.

Growth of Output in Selected Industries



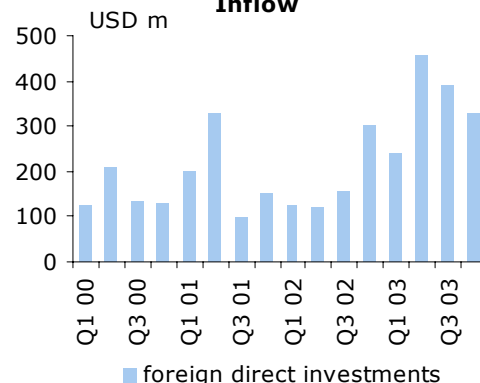
Source: Derzhkomstat

Domestic Production and Consumption of Grain



Source: Derzhkomstat
Note: F -- forecast of the Ministry of Agrarian Policy

Foreign Direct Investments Inflow



Source: NBU

Fiscal policy: Special VAT accounts to be introduced in May

In response to a presidential order, the Cabinet of Ministers and the National Bank of Ukraine adopted a resolution that introduces a system of special VAT accounts starting from May 1st. All VAT payers are required to open separate accounts to be used exclusively for servicing VAT payments and transferring some tax payments to the state. The government expects that this innovation will significantly improve VAT collection by preventing fraudulent schemes with VAT refunds, and therefore will solve the long-standing problem of accumulating VAT refund arrears. The system is likely to improve the VAT administration and tax collection, however, at the expense of decreased cash flows for the enterprises. Since the enterprises are forbidden to transfer any funds from VAT accounts to other accounts, they will need to attract additional financing, such as bank credits, to cover any cash flow shortage. This might increase costs of producers and, finally, spill over into output prices.

The President vetoed a law on changes to the taxation laws, which had been approved by parliament in February. This law, meant as complementary to the Law on the State Budget 2004, envisaged the restoration of selected VAT privileges, higher excises and a reduction of the VAT rate to 17% in 2005. The President declared that the law did not conform to the constitution and to tax regulations. The government plans to resubmit the most crucial clauses to parliament in separate draft laws.

The central fiscal revenues were 1% higher than projected in January and February, while the central fiscal expenditures' execution were 18% below the targeted level.

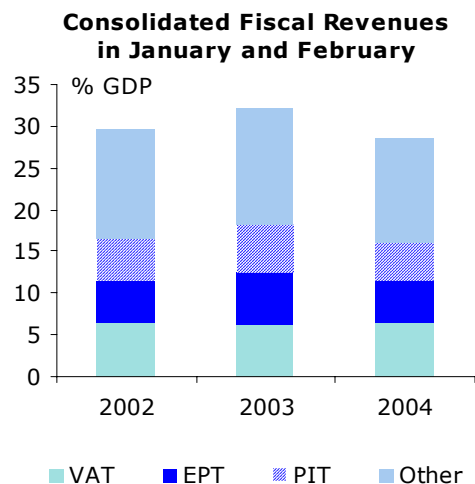
Monetary policy: The NBU strives to improve its control over bank liquidity

Since the beginning of March the NBU has taken several steps to enhance its control over the liquidity position of banks and over interbank interest rates dynamics. First, the NBU tried to influence the banks' demand for standing facilities by changing its overnight refinancing rate frequently, albeit by small amounts. In addition, the NBU obliged the commercial banks to report the volumes of all their operations in the interbank market on a daily basis. According to the Head of the Monetary Policy Department, Natalia Hrebenyk, the daily monitoring will help to reduce the volatility of the market and enhance its predictability. More generally, these measures may contribute to establishing a closer connection between NBU rates and market interest rates, thus allowing the monetary authorities to improve the effectiveness of their monetary policy instruments. Nevertheless, it seems that the dynamics of refinancing rates still has little effect on the interbank market, and more time and effort are needed to strengthen this relationship.

In March, the dynamics of monetary aggregates and prices followed the usual trend: the monetary base grew by 32,7% yoy, while the CPI grew by 6,6% yoy.

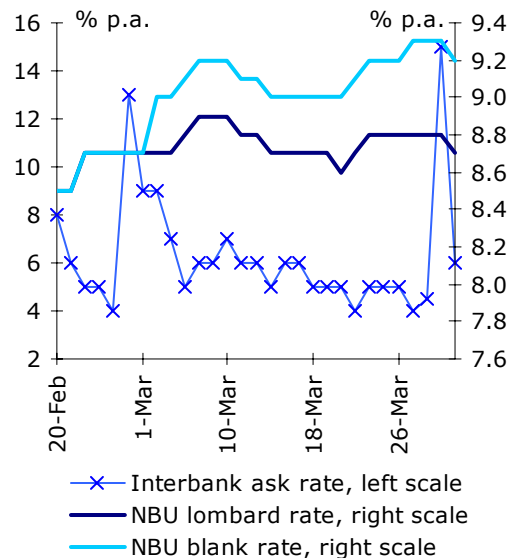
Financial markets: The regulative capital adequacy requirement ratio was raised

Banking sector. Aiming at increasing the capitalization of the banking sector, thus promoting its stability and reliability, the NBU tightened its requirement for bank regulative capital adequacy on March 1st. The ratio of a bank's regulative capital to its total assets, weighted for its riskiness, was increased from 8% to 10%. According to the NBU, all banks have fulfilled the new requirement. Despite bankers' claims, the increase of the ratio did not affect the functioning of the banking sector. Interest rates for credits in both national and foreign currencies did not change much, and the volume of loans continued to follow an upward pattern.

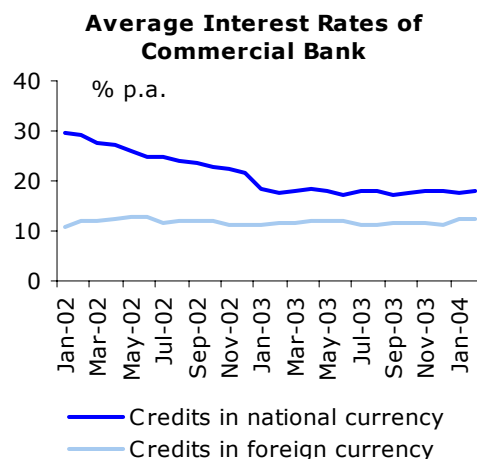


Source: Treasury report

Interbank and NBU Overnight Rates



Source: NBU, Ukrainian financial server



Source: NBU



Economic Trends		Q4 02	Q1 03	Q2 03	Q3 03	Q4 03	Nov	Dec	Jan	Feb	Mar
GDP growth (real)	% yoy	6.1	8.4	10.0	6.8	12.1	12.1	...	9.0	11.5	...
GDP growth (real)	% yoy cum.	5.2	8.4	9.2	8.3	9.4	7.7*	8.5*	9.0*	10.2*	...
Industrial production (real)	% yoy cum.	7.0	10.7	12.4	15.2	15.8	15.5	15.8	16.1	18.2	...
Agricultural production (real)	% yoy cum.	1.2	1.3	-6.0	-16.6	-10.2	-12.3	-10.2	-6.4	-5.9	...
CPI	% yoy eop	-0.6	4.3	5.9	6.2	8.2	8.1	8.2	8.1	7.4	6.6
PPI	% yoy eop	5.7	9.9	5.3	7.4	11.1	9.4	11.1	12.4	14.9	15.0
Exports (USD)***	% yoy cum.	10.7	24.6	23.8	23.7	24.0	27.9"	28.5"	42.9"
Imports (USD)***	% yoy cum.	4.9	22.8	23.3	25.1	28.7	33.6"	35.6"	29.0"
Merchandise trade balance	USD bn cum.	0.71	0.31	0.27	0.11	-0.27	0.34"	0.06"	0.39"
Current account	USD bn cum.	3.17	1.08	1.81	2.48	2.89	x	x	x	x	x
Current account	% GDP, cum.	7.6	11.2	8.7	7.1	5.9	x	x	x	x	x
Gross international reserves	USD bn eop	4.42	4.60	6.17	6.68	6.94	6.95	6.94	7.04'	7.62'	7.96'
Monetary Base	% yoy eop	33.6	24.4	34.2	31.0	30.2	30.0	30.2	30.0	34.6	32.7
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	17.2
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	5.33	5.71	6.05	6.00	6.34	6.23	6.54	6.73	6.74	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		1996	1997	1998	1999	2000	2001	2002	2003
Nominal GDP	UAH bn	81.5	93.4	102.6	130.4	170.1	204.2	225.8	264.2
Nominal GDP	USD bn	44.6	50.2	41.9	31.6	31.2	37.8	42.6	49.5
GDP growth (real)	% yoy	-10.0	-3.0	-1.9	-0.2	5.9	9.2	5.2	9.4
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	24.0
Imports (gs, USD)	% yoy	17.4	2.0	-14.0	-19.1	18.9	14.1	4.9	28.7
Current account	USD bn	-1.2	-1.3	-1.3	0.9 °	1.2 °°	1.4	3.1	2.9
Current account	% GDP	-2.7	-2.7	-3.1	2.9 °	3.8 °°	3.7	7.6	5.9
FDI (net)	USD bn	0.5	0.6	0.7	0.5	0.6	0.8	0.7	1.4
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:

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