

Monthly Economic Monitor Ukraine

- The Ukrainian Parliament ratified the treaty establishing a Common Economic Space between Ukraine, Russia, Kazakhstan, and Belarus.
- Parliament failed to pass the Constitutional Reform legislation.
- The real GDP grew by 10.8% yoy in the first quarter of 2004.
- Privatisation of the holding company Ukrrudprom will be regulated by a special law.
- In January and February the balance of trade in goods reached a surplus of USD 611 m.
- The introduction of special VAT accounts was postponed till July.
- Development of the monetary sector follows last years' trends.
- The maximum amount of deposit coverage in case of a bank bankruptcy was increased from UAH 2000 to UAH 3000.

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Population: 48 m
Industry/GDP: 28.8%
Agriculture/GDP: 10.9%
Investment/GDP: 19.1%
Export to: Russia 17%, EU-15 20%
Import from: Russia 35%, EU-15 23%

Politics: The Common Economic Space treaty was ratified by Parliament

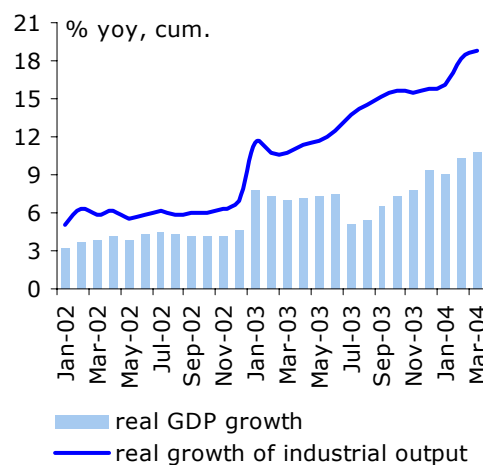
The Verkhovna Rada has ratified the treaty establishing a Common Economic Space (CES) between four countries: Ukraine, Russia, Kazakhstan, and Belarus, as have the parliaments of the other three countries. The treaty envisages the establishment of a customs union followed by coordination in the spheres of tax policy, financial policy, and up to the creation of a monetary union. Ratification of this treaty by Parliament may be seen as a major step by Ukraine towards economic and political integration with these countries, which seems to contradict the proclaimed European orientation of Ukraine's foreign policy. In addition, the coordination process for WTO accession envisaged in the treaty has several negative connotations for Ukraine.

The Verkhovna Rada failed to adopt the constitutional reform package aimed at redistributing power in favour of Parliament and the Prime Minister. Even though backed by President Leonid Kuchma, the necessary 300 votes (out of the 450-seat Verkhovna Rada) were not reached by 6 votes. Nevertheless, pro-presidential politicians, and the President too, promised that they would complete the reform before the presidential elections by reintroducing another draft bill. Yet, the legislation stipulates that the same changes to the constitution can only be considered by Parliament a year after previous trial; thus, any attempt to amend the constitution in time for this year's election would be deemed dubious.

A short time after the failed constitutional reform vote the parliamentary-governmental coalition nominated the current Prime Minister, Viktor Yanukovich, as the coalition's official candidate for the upcoming presidential elections. Thus, Mr. Yanukovich is considered as the main competitor to opposition leader Viktor Yushchenko.

A highly questionable mayoral election took place in the small Trans-Carpathian town of Mukachevo in April. Ernest Nuser, a candidate of the Social-Democratic Party of Ukraine (united), was declared the winner despite the fact that the results of several exit polls indicated that his competitor Viktor Balogha, backed by the opposition bloc 'Our Ukraine', had received the majority of votes. An official parliamentary commission headed by the Vice-Speaker Oleksander Zinchenko, as well as independent observers and opposition deputies reported that the voting process had been marked by serious violations of the law, including the use of brutal force against people's deputies, stealing of ballots, and falsification of the election commission's protocols. Yet, the local court already declared the election results to be valid.

GDP and Industrial Output



Source: Derzhkomstat

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Real economy: The real GDP growth accelerates

The real GDP increased by 10.8% yoy between January and March. The manufacturing industry, transport, the wholesale and retail trades, and construction made for this economic growth, explaining almost three fourth of the total real GDP increase. Due to the poor harvest in 2003, the value added in agriculture declined by 4.1% yoy in real terms during the first three months. However, the expected better grain harvest this year should restore growth later in 2004.

In the first quarter of the year industrial output increased by 18.8% yoy in real terms. The highest growth rate was recorded in machine building (46.3% yoy), which is mainly explained by expansion in the transport and electrical equipment sectors. These figures match with investments demand growth, observed in 2003 and continuing in the first quarter of this year.

Sectoral trends: The holding company Ukrrudprom will be privatised based on a special law

Privatisation. The Verkhovna Rada adopted a law to privatise the holding company Ukrrudprom, which owns Ukrainian ore extracting and processing enterprises. According to the law, each component enterprise of the holding company will be sold separately, with preference given to bidders who currently own 25%+1 share in the respective companies. Although splitting this monopolistic ore supplier into independent companies will contribute to greater competition in the market, granting preferences to current shareholders in the privatisation contest will decrease the competition in the privatisation process, thereby reducing the government's revenues. In addition, the law does not regulate the technical issues of cooperation between ore producers, which is a necessary prerequisite for a sustainable production process. The President having signed the law, the State Property Fund (SPF) is going to start the privatisation tenders on Ukrrudprom in approximately one month.

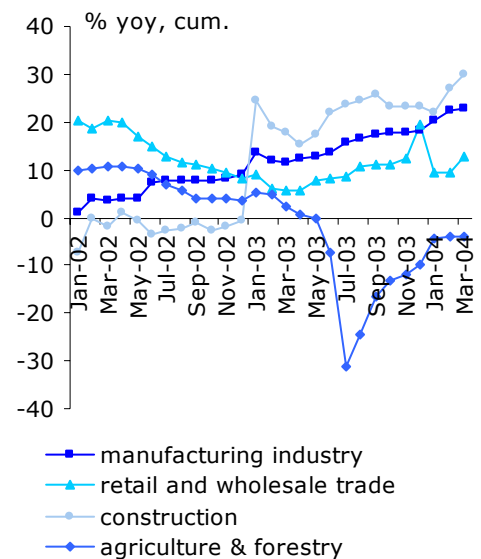
Several large Ukrainian companies (including Interpipe, Azovstal, the Avdievskiy coke plant, Ukrinvest, and some others) known to represent major domestic business groups, have established a financial-industrial consortium, named the Investment-Metallurgical Union. A prime goal of the consortium is considered to be the joining of resources in order to acquire one of the largest Ukrainian metallurgical companies, Kryvorizhstal, the privatisation price of which is estimated by some experts to be around USD 1 bn.

Infrastructure. The State Customs Service and the State Administration for Railway Transport (Ukrzaliznytsia) have signed an agreement to enhance Ukraine's potential in transit transportation. The agreement simplifies the railway transit transportation procedures for excisable goods, cancelling the previously existing obligation of the goods' owners to pay a financial guarantee fee (up to 70% of the value of transported goods) to customs. It is expected that this simplification will attract carriers to explore Ukraine's transit possibilities, which should allow Ukrzaliznytsia to earn USD 500 m more every year.

External Sector: Exports and imports of goods continue to grow

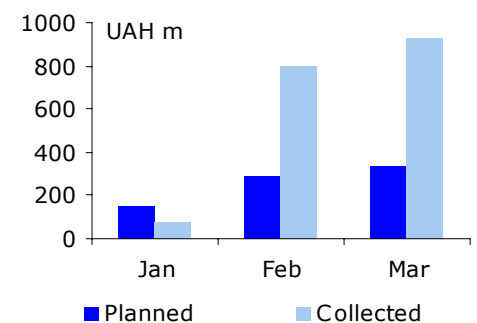
According to Derzhkomstat, exports of goods grew by 44.4% yoy in dollar terms in the first two months of the year, while imports increased by 37.2% yoy. The balance of trade in goods reached a surplus of USD 611 m, compared to USD 284 m in the same period of the previous year. Due to favourable world prices and high foreign demand, ferrous metals remained the main contributor to export growth explaining almost a third of the overall export increase. Another 22% of the growth came from higher exports of the machine-building industry's products, namely machinery, equipment, and transport equipment, especially to CIS countries.

Growth of Value Added in Selected Sectors



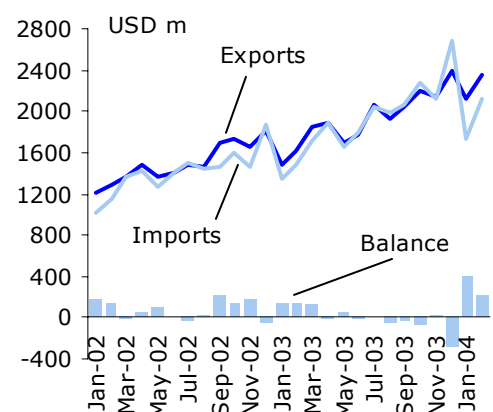
Source: Derzhkomstat

Privatisation Revenues in 2004*



Source: State Treasury
* only general fund of the budget

Merchandise Trade



Source: Derzhkomstat

Imports rose mainly due to growing domestic demand for raw materials and investment goods, such as mineral products, machinery and transport, caused by high economic growth in the country. The rise in imports of these commodities explains 65% of the total import growth. Another important factor influencing the growth rate of imports in the first months of 2004 was grain imports, caused by the poor grain harvest in 2003. This factor is likely to disappear later in 2004 due to an expected better grain harvest.

Fiscal policy: The introduction of special VAT accounts was postponed

The President has recalled his decree introducing VAT accounts, and instead submitted a draft law on VAT accounts to Parliament. According to this draft law, VAT accounts are to be introduced on July 1st, 2004. It is intended that these accounts be used exclusively for executing VAT payments, while other payments from the VAT accounts to the state had been allowed in the decree. In addition, the draft law envisages a reduction of the current VAT rate of 20% to 17% in 2005, and to 15% in 2006. Although the introduction of special accounts is likely to harm enterprises by decreasing their cash flows, they are expected to improve the tax administration, thus justifying the reductions in the VAT rate.

For the first quarter of 2004 central fiscal revenues were 2% above the projections. Central fiscal expenditures also improved reaching 89.5% of target. The central fiscal surplus was UAH 237 m.

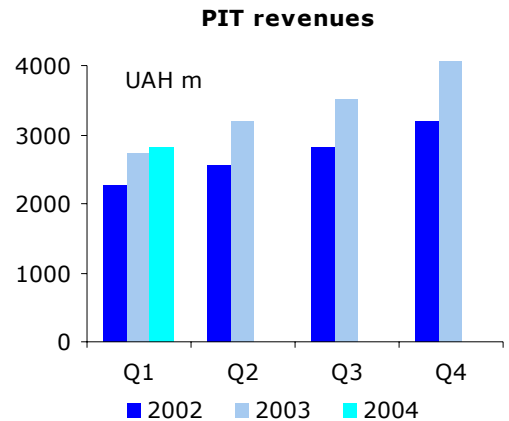
First data concerning personal income tax revenues after the tax rate reduction from the progressive 10-40% scale to a flat 13% rate indicate some success with the tax reform. Between January and March the PIT revenues increased by 3% compared to the same period of 2003. The rate reduction is likely to be compensated by widening of the tax base due to abolishing privileges to military personnel and by some, albeit not very significant, de-shadowing of incomes.

Monetary policy: The development of the monetary sector continues to follow the usual trends

The development of money supply continues to be driven by the same factors as in previous years. Against the background of a sizeable current account surplus, the NBU's policy of keeping the exchange rate at the almost constant level of 5.33 UAH/USD leads to accumulation of international reserves and, consequently, to a quite high growth rate of the money supply. Thus, by the end of April the money supply grew by 44.9% yoy basically fuelled by NBU purchases of foreign currency at the interbank foreign exchange market in the amount of USD 2.7 bn over the last twelve months. However, the rapid monetary expansion is not likely to create inflationary pressures, since consumer price inflation remains in one-digit territory as before, reaching 6.6% yoy in April. This may be explained by such factors as the significant real GDP growth and the monetisation of the economy, which both absorb monetary expansion. Yet, it may well happen that monetary pressures on prices will reappear should the role of these factors diminish.

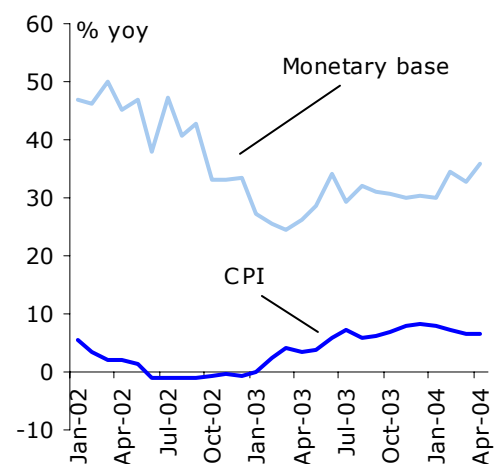
Financial markets: The Deposit Insurance Fund increases deposit coverage

Banking sector. The Deposit Insurance Fund (DIF) has raised the maximum amount of compensation to depositors in case of a bank bankruptcy from UAH 2000 to UAH 3000. The purpose of the increase is to enhance deposit protection, thus raising confidence in the banking system. Although the level of deposit coverage in Ukraine has now reached 60% of GDP per capita, it is still below the world average of 3 times GDP per capita. Thus, the maximum amount of coverage is likely to be increased further once household deposits grow more allowing the DIF to accumulate enough capital.



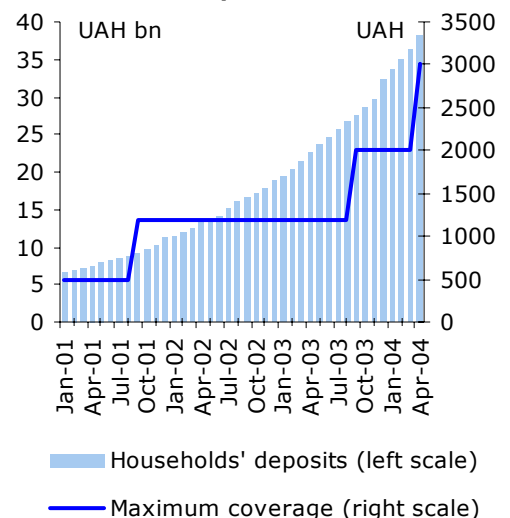
Source: State Treasury

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

Households' Deposits and Maximum Amount of Compensation



Source: DIF, NBU



Economic Trends		Q4 02	Q1 03	Q2 03	Q3 03	Q4 03	Dec	Jan	Feb	Mar	Apr
GDP growth (real)	% yoy	6.1	8.4	10.0	6.8	12.1	n/a	9.0	11.5	11.8	...
GDP growth (real)	% yoy cum.	5.2	8.4	9.2	8.3	9.4	8.5*	9.0*	10.2*	10.8*	...
Industrial production (real)	% yoy cum.	7.0	10.7	12.4	15.2	15.8	15.8	16.1	18.2	18.8	...
Agricultural production (real)	% yoy cum.	1.2	1.3	-6.0	-16.6	-10.2	-10.2	-6.4	-5.9	-4.0	...
CPI	% yoy eop	-0.6	4.3	5.9	6.2	8.2	8.2	8.1	7.4	6.6	6.6
PPI	% yoy eop	5.7	9.9	5.3	7.4	11.1	11.1	12.4	14.9	15.0	18.4
Exports (USD)***	% yoy cum.	10.7	24.6	23.8	23.7	24.0	28.5"	42.9"	44.2"
Imports (USD)***	% yoy cum.	4.9	22.8	23.3	25.1	28.7	35.6"	29.0"	37.1"
Merchandise trade balance	USD bn cum.	0.71	0.31	0.27	0.11	-0.27	0.06"	0.39"	0.61"
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	6.94	7.06	7.64	7.96'	8.28'
Monetary Base	% yoy eop	33.6	24.4	34.2	31.0	30.2	30.2	30.0	34.6	32.7	35.9
Lending rate on UAH credits **	% pa, eop	19.5	17.9	17.2	18.1	17.9	17.9	17.8	18.0	17.2	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	6.54	6.73	6.74	6.54	6.40

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