

Monthly Economic Monitor Ukraine

- The European Commission denied granting Ukraine Market Economy Status.
- The real GDP grew by 11.5% yoy between January and April, while industrial output increased by 17.7% yoy.
- Oil product prices grew sharply at the end of May.
- The State Property Fund announced a privatisation tender for Kryvorizhstal, the largest metallurgical enterprise in Ukraine.
- The balance of trade in goods remained positive at USD 857 m in the first quarter of the year.
- A 2005 budget resolution was submitted to Parliament in May.
- The NBU introduced a new regulation that will help to improve control over bank liquidity.
- The banking sector continues to expand rapidly.

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June
2004**

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: Ukraine failed to obtain the Market Economy Status from the EU

The European Commission again denied granting Ukraine Market Economy Status (MES). According to the official letter of the European Commission to the Minister of Economy of Ukraine, two obstacles prevented granting MES to Ukraine: continuous state intervention in price-setting mechanisms and shortcomings in the bankruptcy legislation. The Market Economy Status would place Ukraine in a much more advantageous position in numerous anti-dumping trade investigations with EU member-countries, and thus, would promote Ukrainian exports to one of the largest markets. To reach MES, however, Ukraine must first demonstrate a strong intention and eliminate the two obstacles listed in the letter.

A summit of the presidents of Ukraine, Russia, Kazakhstan, and Belarus, participating countries in the Common Economic Space Agreement, took place in the city of Yalta. No important documents were signed during the summit, while the presidents agreed on a list of priority intergovernmental treaties regarding further integration, which are to be signed in the nearest future. The next meeting will take place in September 2004 and is expected to be marked by more serious actions by each of the participating countries.

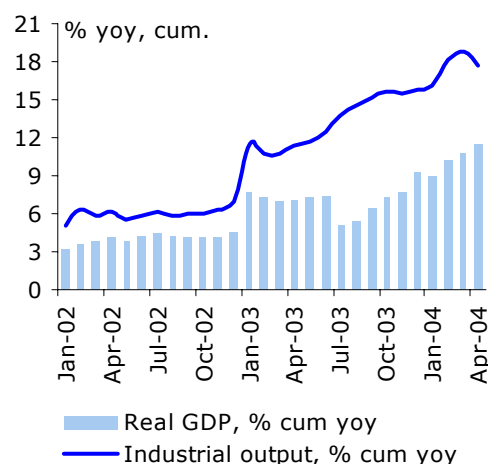
The struggle over the mayoralty position in the town of Mukachevo continues. Ernest Nuser, the declared winner of a highly questionable mayoral election, which took place in April, announced his resignation at the end of May, claiming that frequent threats against his family and himself obliged him to do so. The resignation further defers the installation of a legitimate executive in the small Trans-Carpathian town.

Real economy: High economic growth continues

The real GDP has maintained its high growth established at the beginning of 2004. According to Derzhkomstat, it reached 11.5% yoy in the first four months of the year, compared to a 7.1% yoy increase for the same period of 2003. The major sectors contributing to this growth were the manufacturing industry, construction, the wholesale and retail trades, and transport. The most impressive growth of value added was reported in construction (31.9% yoy), mainly in the construction of industrial units, indicating continued high investment activity in the country.

Between January and April industrial output increased by 17.7% yoy, mostly due to high growth rates in the manufacturing and extractive industries. Machine building increased by 40.2% yoy, thanks to expanding production in the sectors of electric and transport equipment. Responding to the high demand from the construction sector, the growth of non-metal mineral products reached 31.7%

GDP and Industrial Output



Source: Derzhkomstat

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yoy, compared to 4.3% for the same period of 2003. High growth rates were also observed in metallurgy. The increase in world oil prices could slowdown the expansion of industrial output during the second half of the year, since a significant part of Ukraine's industries are energy-intensive, and further increases in oil prices will raise the cost of production, negatively affecting industrial output growth.

Sectoral trends: Petroleum products prices hiked

Energy. The prices for petroleum products started to rise sharply in Ukraine, increasing about 30 to 40% during the last two weeks of May. Petroleum product producers blame the price increases on increases in the world oil prices. Several large Ukrainian oil refineries were shut down for maintenance in May, which also caused upward pressures on the price of oil products. The Ukrainian government failed to react in time and tried to catch up by strict administrative measures, such as suspending exports of oil products, investigating alleged collusion in the marketplace, making tax checks at the oil refineries, etc. While these measures may reduce petroleum prices a little, the prices of many other goods will likely start growing.

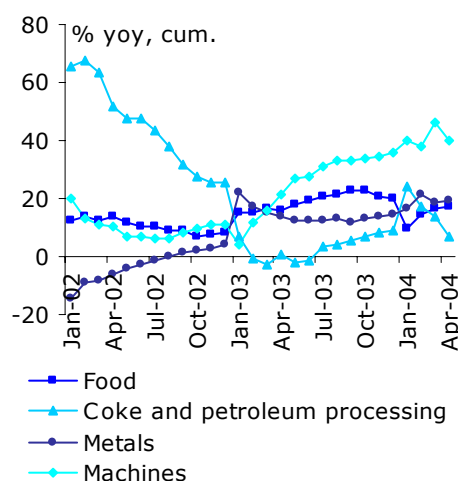
Privatisation. The State Property Fund (SPF) has announced a privatisation tender for the 93.02% stake in the largest and highly profitable Ukrainian state-owned metallurgical enterprise Kryvorizhstal. Kryvorizhstal is a blue chip in the Ukrainian economy; the estimated value of the offered stake is about USD 1 bn. The list of investors having already expressed an interest in the privatisation contest includes Investment-Metallurgical Union, a newly created Ukrainian industrial alliance, as well as major international steel producers (Severstal, Arcelor, LNM Group, USSteel, and TATA Steel). However, the openness and competitiveness of the privatisation tender are severely reduced by a restriction imposed by the SPF: it requires the potential investor to have experience in producing coke in Ukraine for three years. The restriction does not seem to be backed by any sound economic or technical reasons, but pointedly tailors the privatisation contest to Ukrainian investors, practically eliminating all other interested parties. This in turn, decreases Ukraine's chances to obtain the best possible price for one of its most attractive state-owned companies.

Infrastructure. The Ministry of Transport started the construction of a deep navigation canal between the Danube and the Black Sea, which is planned to be completed by autumn 2005. The total cost of the project is estimated at about UAH 210 m. It is expected that the canal would attract 60% of the Danube freight flow to the Ukrainian canal, away from the current monopolistic Romanian one. However, the National Academy of Science and several ecological organisations oppose this project, claiming that it would worsen the ecological situation in the Danube delta.

External Sector: Balance of trade in goods remains high

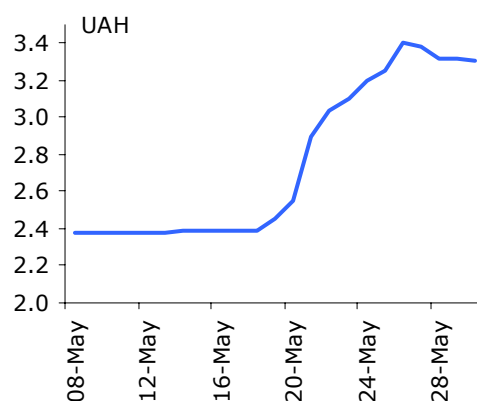
According to Derzhkomstat, exports of goods increased by 45.2% yoy in dollar terms over the first three months of the year, while imports grew by 39.2%. Ukraine maintained its positive balance of trade in goods at USD 857 m, twice as high than during the same period of the previous year. Exports increased to all regions of the world: to the USA by 60%, to Europe and the CIS by 50%, and to Asia and Africa by more than 30%. The trade with the Baltic countries augmented quite considerably, likely in anticipation of the removal of the free trade agreements with these countries once they become members of the EU custom union. It is expected that Ukraine will lose up to 6% of its exports to the Baltic countries as a result of the loss of these free trade agreements, but it should also gain some trade with other new EU members due to the more liberal tariff rates of the EU.

Growth of Output in Selected Industries



Source: Derzhkomstat

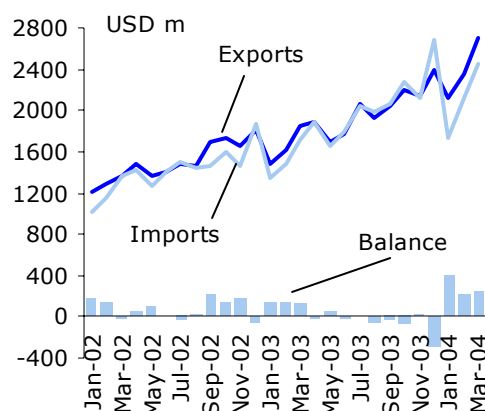
Retail prices on gasoline in Ukraine*



* A-95 type gasoline

Source: Ukrainian financial server

Merchandise Trade



Source: Derzhkomstat

Fiscal policy: The Budget Resolution for 2005 was submitted to Parliament

The Budget Resolution for 2005, which stipulates the main fiscal guidelines for the coming year, was submitted to Parliament. The Resolution is based on a forecasted 6.5% real GDP growth and a 6.0% inflation rate. According to the Resolution, the revenues to GDP ratio will remain at the 2004 level, and the fiscal deficit will not exceed 1.0% of GDP. Next year's budget was drafted on the basis of continuing tax reform, which among other measures includes a reduction of the VAT rate from 20% to 17%. This rate decrease is expected to be compensated for by an improved tax administration, an expansion of the tax base and de-shadowing of the economy.

102% of the budgeted central fiscal revenues were collected during the period of January to April, while the expenditures execution ratio rose to 92% from 89% in January-March. The central fiscal surplus was UAH 209 m.

The first data on the performance of enterprise profits tax (EPT) collection after the rate reduction from 30% to 25% indicate some success with the tax reform. Between February and April, the first three months during which the reduced rate was effective, nominal EPT revenues grew by 3% as compared to the same period last year. Part of this increase could be due to better enterprise performance caused by economic growth and by some de-shadowing of profits. Anticipation of the rate reduction could also have affected enterprise profits and consequently the EPT collection rate.

The Verkhovna Rada approved a law increasing the subsistence minimum for the year 2004 to UAH 362 (from UAH 342). The subsistence minimum is used when calculating the amount of social assistance, such as minimum unemployment benefits, assistance for childbirth, etc. While this measure increases the amount of funds allocated to social assistance in nominal terms, in real terms it remains at approximately last year's level.

Monetary policy: The NBU undertakes further steps towards improving its control over bank liquidity

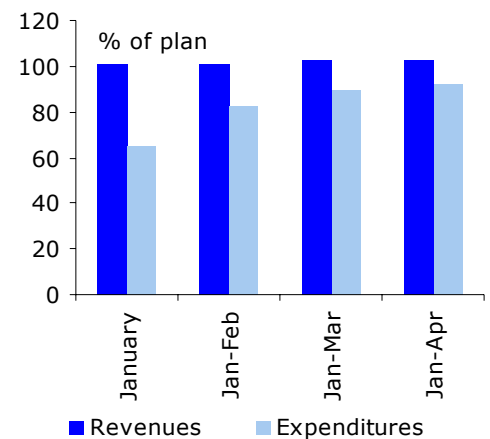
In May the NBU introduced a new regulation regarding bank reserve requirements. According to the new NBU decree, which comes into force on July 1, the bank reserves – a certain share of all banks' liabilities, which are to be kept on a correspondent account with the NBU – will be verified both on a daily basis and as an average for each month, while before only the monthly average figure was monitored. The decree will help the NBU to reduce the volatility of the interbank interest rate, eliminating especially the regular jumps observed just before each monthly average check. Thus, the decree can be considered another step by the NBU towards improving its control over bank liquidity and increasing the efficiency and flexibility of its monetary policy instruments.

In May the monetary base grew by 41.5% yoy, while consumer prices increased by 7.4% yoy. The upsurge of gasoline prices had unproportionally small effect on the consumer price index in May because of the low weight of gasoline in the consumption basket, but is likely to contribute to higher inflation later on through increases in prices on all types of consumption goods.

Financial markets: Banking sector continues to expand

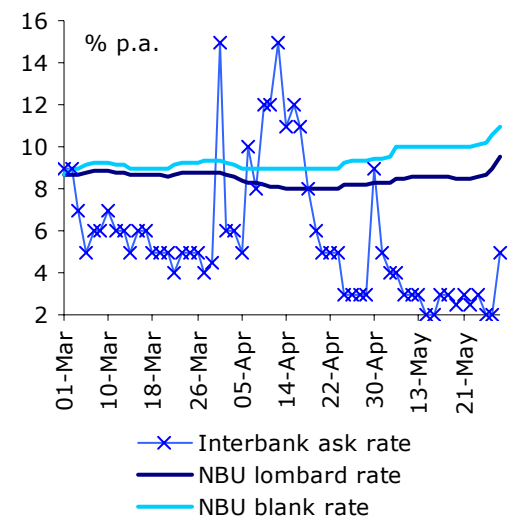
Banking sector. From January to April the banking sector continued to show growth in its main indicators. On the liability side, the volume of bank deposits grew by 55% yoy, mainly due to inflows of household deposits, which grew by 68% yoy. On the asset side, the rate of growth of credits reached 59% yoy. The minor reduction in bank interest rates seen last year did not continue during early 2004, indicating that risks in the economy remain rather high. Hence, Ukraine's banking sector is dynamically developing, though it remains relatively small compared to the needs of the economy.

Central Fiscal Execution in 2004



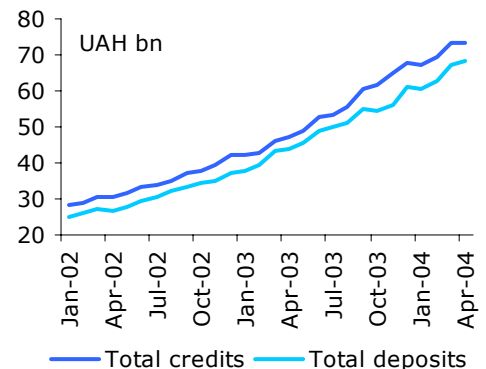
Source: State Treasury

Interbank and NBU Overnight Rates



Source: NBU, Ukrainian financial server

Volumes of Bank Credits and Deposits



Source: NBU



Economic Trends		Q4 02	Q1 03	Q2 03	Q3 03	Q4 03	Jan	Feb	Mar	Apr	May
GDP growth (real)	% yoy	6.1	8.4	10.0	6.8	12.1	9.0	11.5	11.8	13.3	...
GDP growth (real)	% yoy cum.	5.2	8.4	9.2	8.3	9.4	9.0*	10.2*	10.8*	11.5*	...
Industrial production (real)	% yoy cum.	7.0	10.7	12.4	15.2	15.8	16.1	18.2	18.8	17.7	...
Agricultural production (real)	% yoy cum.	1.2	1.3	-6.0	-16.6	-10.2	-6.4	-5.9	-4.0	-2.6	...
CPI	% yoy eop	-0.6	4.3	5.9	6.2	8.2	8.1	7.4	6.6	6.6	7.4
PPI	% yoy eop	5.7	9.9	5.3	7.4	11.1	12.4	14.9	15.0	18.4	20.6
Exports (USD)***	% yoy cum.	10.7	24.6	23.8	23.7	24.0	42.9"	44.2"	45.2"
Imports (USD)***	% yoy cum.	4.9	22.8	23.3	25.1	28.7	29.0"	37.1"	39.2"
Merchandise trade balance	USD bn cum.	0.71	0.31	0.27	0.11	-0.27	0.39"	0.61"	0.86"
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	7.06	7.64	7.92	8.28'	8.99'
Monetary Base	% yoy eop	33.6	24.4	34.2	31.0	30.2	30.0	34.6	32.7	35.9	41.5
Lending rate on UAH credits **	% pa, eop	19.5	17.9	17.2	18.1	17.9	17.8	18.0	17.2	17.2	17.4
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	6.73	6.74	6.54	6.40	6.39

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