



Monthly Economic Monitor Ukraine

- The Ukrainian presidential election campaign has started.
- According to the revised quarterly information, the real GDP increased by 12.3% yoy during the first quarter of 2004.
- Ukraine privatised a large coal-mining company Pavlogradvuhillya and part of ore extracting and enriching holding UkrRudProm.
- The balance of trade in goods reached a surplus of USD 2.1 bn or 10.1% GDP bn after the first five months of the year.
- The central fiscal balance switched from a surplus to a deficit of UAH 223 m.
- The NBU undertook further steps to reduce the rapidly growing bank liquidity.
- Ukraine successfully issued USD 500 m of eurobonds with a floating yield.

**No.8 (46)
August
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%

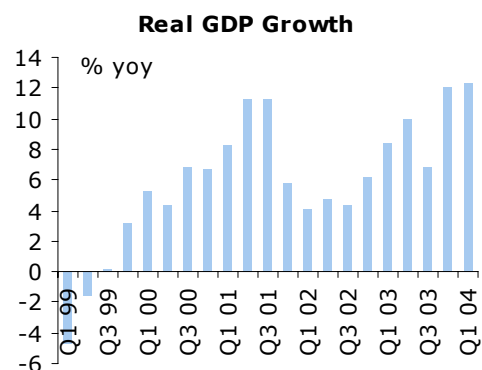
Politics: Presidential election campaign started

The Ukrainian presidential election campaign of 2004 has officially started. Voting will take place on October 31 and its results should be known by November 10. If the second round of voting is to be held, final outcome is expected by December 6, the latest. In any case the new leader of Ukraine should assume office by December 13. As of July 29 there were 22 presidential candidates registered. Two major candidates are leading in the opinion polls: Viktor Yushchenko, leader of the parliamentary faction "Our Ukraine", and Viktor Yanukovich, the Prime-Minister of Ukraine. The present President of Ukraine, Leonid Kuchma, has repeatedly denied that he would participate in the election, notwithstanding his right to do so, as confirmed by the Constitutional Court. NATO, OSCE, PACE, the EU and the USA have called on Ukraine to conduct a fair and transparent election. Large number of international observers is expected to monitor the event.

The Cabinet of Ministers of Ukraine has dropped the requirement to operate the Odessa-Brody pipeline only in the Odessa to Brody direction. This will allow the pipeline to be used in the reverse mode, pumping Russian oil from Brody to Odessa, for transshipment from there through the Bosphorus to final consumers. The Russian-British company TNK-BP, which for a long time lobbied for this change, will be the main operator of the pipeline. The European Commission (EC) and Turkey have voiced some concern over the reverse usage of the pipeline, which might overload the Bosphorus, further endangering the ecological situation in the Black Sea region. The Ukrainian government is motivated its decision by the ability to earn immediate profits and to put the pipeline's use.

Real economy: The real GDP growth rate is higher than initially estimated

According to Derzhkomstat's quarterly publication, the real GDP increased by 12.3% yoy during the first quarter of 2004. This is 1.5 percentage points higher than initially estimated on a monthly basis. In line with the monthly information, the growth of value added in manufacturing, construction, internal trade and transport made for the overall strong economic growth. The increase in the GDP growth figure compared to the monthly estimate is attributed to higher growth in the wholesale and retail trades that reached 23.5% (rather than 12.6% yoy on the monthly basis). The growth derived primarily from the wholesale trade in intermediary goods, e.g. metals, backed by a strong industrial performance in the country. On the demand side, both domestic consumption and investments exhibited high growth rates in the first quarter. In particular, gross fixed capital accumulation increased by 23.3% yoy, mirroring the growth in construction and machine building.



Source: Derzhkomstat

Institute for Economic Research
and Policy Consulting
Reitarska 8/5-A, 01034 Kyiv
Tel. (+38044) 228-6342
Fax (+38044) 228-6336
E-mail: institute@ier.kiev.ua
<http://www.ier.kiev.ua>



According to the monthly information, the growth rate of the real GDP from January to June was 12.7% yoy.

Sectoral trends: The privatisation process intensifies

Privatisation. Privatisation of UkrRudProm, a holding company with consolidated state-owned assets in the ore extracting and enriching industry, started in July. The State Property Fund (SPF) has sold state-owned stakes in four ore-enriching plants for total of UAH 495 m and has announced the tender for a 93.07% share in the Kryvorizkiy Zalizorudniy Kombinat at a the starting price of UAH 243 m. Due to severely restrictive conditions applying to the tenders for these privatisation contests, which imply priority rights for insiders, the prices realised for the state-owned shares of UkrRudProm's branches are considered to be well below the market.

In July the SPF also sold the 92.11% state-owned stake in Pavlogradvuhillya, which produces 14% of the Ukrainian coal output, for UAH 1.4 bn to the Avdiyivskiy Coking Plant. Additionally, a 34.57% share in the largest coalmine in Ukraine (Chervonoarmiyska-Zahidna N1 coalmine) was sold for its nominal value of UAH 79.63 m via the Ukrainian Interbank Foreign Exchange.

According to a resolution of the Cabinet of Ministers, the privatisation of the 42.86% stake in Ukraine's major telecommunications operator Ukrtelecom should take place prior to September 30. The starting bid is expected to be about UAH 2.7 bn.

The intensification of privatization process on the eve of presidential election allows the government to collect unprecedented amount of revenues to state coffers. However, due to inappropriate timing of some sales and restrictive conditions applied to contests, the outcome of privatization in terms of efficiency of new private owners and adequacy of collected revenues is far from satisfactory.

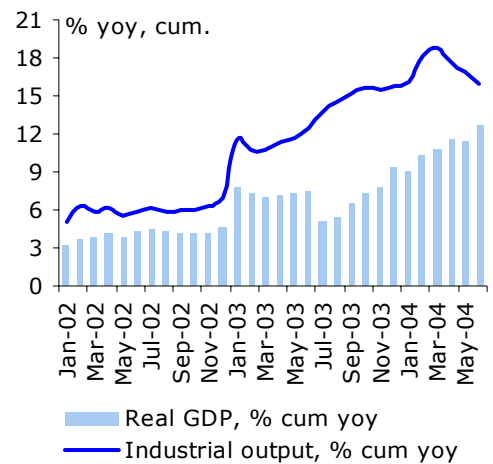
Energy. Parliament has adopted a law on accumulation of resources for the closure of nuclear facilities. Any operator of a nuclear power plant must open a special account in a bank authorized by the Cabinet of Ministers immediately upon starting the operation of his nuclear facility. The organisation operating the nuclear facility will have the right to invest up to 75% of the amount of funds that have accumulated in the account. This decision is a positive one for it will help to formulate cost reflective tariffs for nuclear energy.

The EBRD and Euroatom will issue two loans in the amount of USD 42 m and USD 83 m respectively for the upgrading of the second reactor of the Khmelnytskyi and fourth reactor of the Rivne nuclear power plants. Both loans were endorsed by the European Commission. This decision has long been awaited by Ukraine and will allow bringing the newly constructed nuclear facilities up to the European safety levels.

External Sector: The trade turnover increases with all regions

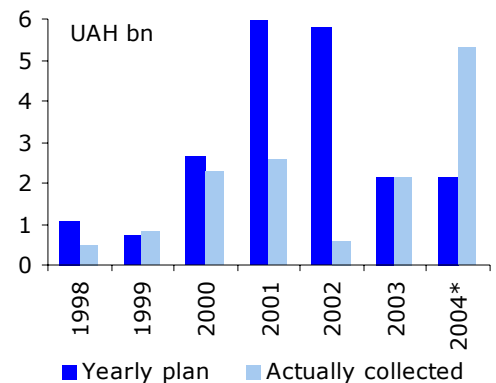
According to Derzhkomstat, exports of goods increased by 51.3% yoy in dollar terms, while imports grew by 32.5% yoy during the first five months of 2004. The positive balance of trade in goods reached USD 2.1 bn compared to USD 0.4 bn during the same period of the previous year. Ukraine intensified exports to all regions of the world. In particular, its exports to the CIS countries increased by 60%, to Europe by 49%, and to Asia by 38%. Exports are still dominated by ferrous metals and ferrous metal products, which together make up 39% of total exports. At the same time, a twofold increase in exports of machinery and transport equipment could signal a gradual change in export orientation for Ukraine towards higher value-added products. On the import side, the highest increase in trade was with Asia (42% yoy), followed by Europe (33%), and the CIS (31%). Although energy materials remained the major import items, the most rapid growth was for machinery and transport equipment due to increasing investment activity in the country.

GDP and Industrial Output



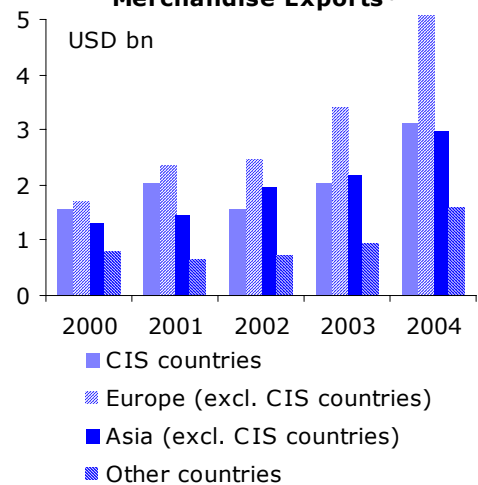
Source: Derzhkomstat

Privatisation Revenues



*Collected as of July 1, 2004
Source: State Treasury

Regional Distribution of Merchandise Exports*



* data for January -- May of a respective year
Source: Derzhkomstat

According to a resolution by the Cabinet of Ministers, tariffs for railway export/import transportation of some types of goods were raised by 15 to 96%. In particular, the tariffs for export transportation of ore, petroleum products, power-generating gases, grain and other products were increased. The Ministry of Transport argues that the increases reflect the high investment needs to upgrade the railway system. However, these measures could also be interpreted as an intensified use of non-tariff barriers as instruments of state trade policy.

Fiscal policy: Central fiscal deficit reached UAH 223 m

For the period of January to June, the execution of the central fiscal revenues stayed at about 102% primarily due to higher than expected economic growth. The execution rate of the central fiscal expenditures improved slightly reaching 93% compared to 90% for January to May. This caused the central fiscal surplus of UAH 379 m for January-May to switch to a deficit of UAH 223 m.

According to the State Treasury, as of July 1 the funds accumulated in the State Treasury accounts constituted UAH 8.5 bn. Apart from over execution of revenues and under execution of expenditures, this accumulation of resources was caused by privatisation receipts for the Kryvorizhstal metallurgical plant. Taking into account the intensified privatisation in July, this figure is likely to increase further. According to the budget amendments, the added revenues will be used to finance an increase in the minimum wage, pensions benefits and other social purposes; thus, if spent over a short period of time, they could contribute to an upsurge of consumer prices.

Monetary policy: The NBU continues its sterilization measures

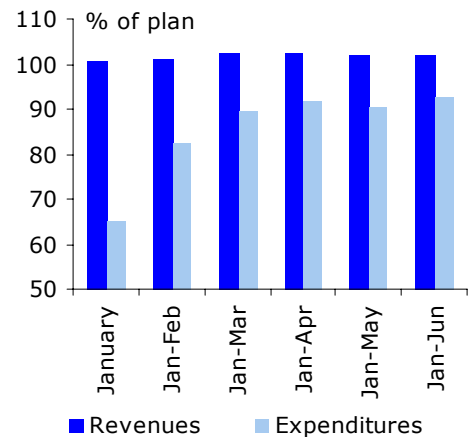
The NBU continued sizeable interventions on the foreign exchange market in July. Due to the high trade balance surplus, the NBU purchased USD 1.6 bn net. As a consequence, the banking sector again experienced a surplus of liquidity, pushing the interbank interest rate down to about 1 to 2% p.a. To absorb this excess liquidity, the NBU undertook sterilization measures totalling UAH 3.3 bn, mainly through sales of certificates of deposits. As a result, the growth rate of the monetary base was 39.2% yoy in July. According to the central bank authorities, should the situation persist later on, these sterilization measures will be continued. So far the NBU was successful in absorbing the excess money supply; however, its sterilization capacity remains limited due to the underdevelopment of its sterilization instruments.

In July the consumer price inflation reached 8.1% yoy, while producer prices grew by 21.3% yoy. The high growth rate of producer prices observed from the beginning of the year is to great extend caused by an increase in the price of coke and oil refinery products, which may spill over into consumer price inflation later.

Financial markets: Ukraine issued USD 500 m of eurobonds

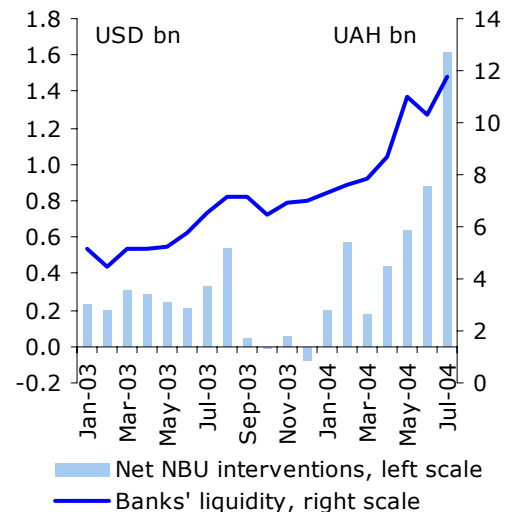
At the end of July Ukraine successfully sold USD 500 m 5-year eurobonds with a floating yield equal to 6-month Libor + 337.5 basis points as a risk premium. As of the placement date the yield was 5.36% p.a., which is the lowest yield for Ukrainian eurobonds. The successful placement of state debt securities is attributable to the country's good economic performance this year as well as to the assignment to this issue B+ rating by the S&P and Fitch rating agencies. The major risk of the issue is associated with the Libor volatility and its recent rising tendencies that may increase the costs of debt servicing. In addition, the Kyiv municipal administration sold USD 200 m seven-year eurobonds with an 8.625% yield in mid-July. The money raised from this issuance will mainly be spent on capital infrastructure development. The success of both issues reflects foreign investor interest and the attractiveness of the Ukrainian economy despite increasing political uncertainty.

Central Fiscal Execution in 2004



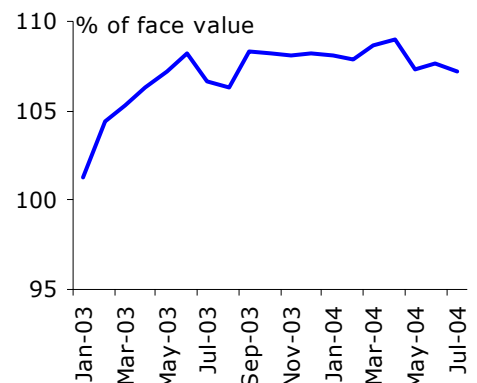
Source: State Treasury

NBU Interventions on Foreign Exchange Market and Banks' Liquidity*



*Funds on correspondent accounts plus vault caash
Source: NBU

Price of Ukrainian Eurobonds in 2003-2004*



* Denominated in euro, quoted at the Dusseldorf Stock Exchange
Source: Sokrat Investment Company



Economic Trends		Q1 03	Q2 03	Q3 03	Q4 03	Q1 04	Mar	Apr	May	Jun	Jul
GDP growth (real)	% yoy	8.4	10.0	6.8	12.1	12.3	11.8	13.3	10.3	19.1	...
GDP growth (real)	% yoy cum.	8.4	9.2	8.3	9.4	12.3	10.8*	11.5*	11.3*	12.7*	...
Industrial production (real)	% yoy cum.	10.7	12.4	15.2	15.8	18.8	18.8	17.7	16.9	15.9	...
Agricultural production (real)	% yoy cum.	1.3	-6.0	-16.6	-10.2	-4.0	-4.0	-2.6	-2.7	-1.5	...
CPI	% yoy eop	4.3	5.9	6.2	8.2	6.6	6.6	6.6	7.4	8.0	8.1
PPI	% yoy eop	9.9	5.3	7.4	11.1	18.4	15.0	18.4	20.6	22.4	21.3
Exports (USD)***	% yoy cum.	24.6	23.8	23.7	24.0	38.8	45.2"	49.3"	51.3"
Imports (USD)***	% yoy cum.	22.8	23.3	25.1	28.7	32.6	39.2"	34.0"	32.5"
Merchandise trade balance	USD bn cum.	0.31	0.27	0.11	-0.27	0.77	0.86"	1.55"	2.14"
Current account	USD bn cum.	1.08	1.81	2.48	2.89	1.67	x	x	x	x	x
Current account	% GDP, cum.	11.2	8.7	7.1	5.9	14.3	x	x	x	x	x
Gross international reserves	USD bn eop	4.60	6.17	6.68	6.94	7.92	7.92	8.13	8.87	9.80'	11.18'
Monetary Base	% yoy eop	24.4	34.2	31.0	30.2	32.7	32.7	35.9	41.5	34.2	39.2
Lending rate on UAH credits **	% pa, eop	17.9	17.2	18.1	17.9	17.2	17.2	17.2	17.4	16.6	17.0
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.33	5.33	5.33	5.33	5.33	5.32	5.32
Exchange rate (official)	EUR aop	5.71	6.05	6.00	6.34	6.67	6.54	6.40	6.39	6.46	6.53

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).

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