



Monthly Economic Monitor Ukraine

- Ukraine and Russia signed several agreements on gas and oil cooperation.
- The real GDP grew by 13.5% yoy between January and July, partially due to a recovery in the agricultural sector.
- This year Ukraine has already harvested nearly 35 m tons of grain, that is 75% more than the total harvest in 2003.
- Despite protests by ecological groups of the EU, Ukraine opened the Danube-Black Sea deep-water navigation canal.
- Within the framework of the WTO negotiations, Ukraine signed a protocol with Argentina for accession to markets for goods and services.
- Fiscal expenditures were executed at 90% of the budgeted level despite an accumulation of UAH 10.6 bn in the state accounts.
- Continuing its policy of suppressing monetary expansion, the NBU changed the reserves requirement ratios for commercial banks.

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September
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: Several agreements on gas and oil cooperation were signed by Ukraine and Russia

During the August meeting of the presidents of Ukraine and Russia, Leonid Kuchma and Vladimir Putin, several documents were signed concerning gas and oil cooperation. An agreement on the transit of Russian oil through Ukraine was signed without mentioning specific figures; while in the gas sphere the agreements were more detailed. It is planned that deliveries of Turkmenistanian gas to Ukraine will be rising from 44 bn cubic meters in 2005 to 60 bn cubic meters per year for the years 2007 to 2028. Also, a new company RosUkrEnergo, formed by companies affiliated with the Russian Gazprom and the Austrian Raiffeisenbank, will take the place of EuralTG in servicing the transit of the gas from Turkmenistan through Ukraine.

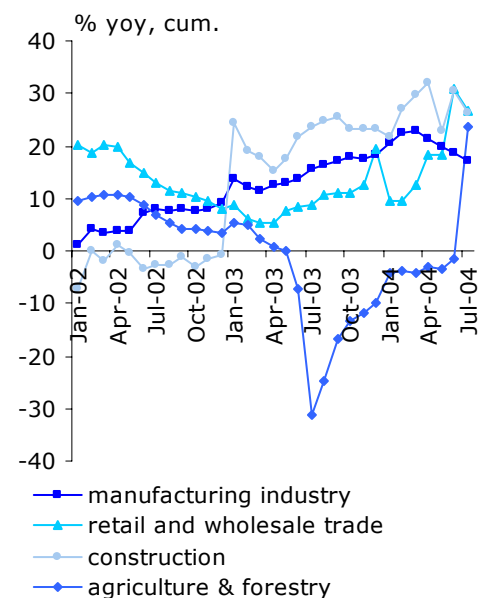
The agreements also allowed Naftogaz Ukrainy to settle the long-outstanding issue of debts for gas (consumed by Ukraine between 1997 and 2000) with Russian Gazprom. Previously, Gazprom refused to accept the bonds of the Naftogaz to avoid tax liabilities. Now the debt is to be settled through pre-payments of services for Russian gas transit through Ukraine's territory from 2005 to 2009, totalling USD 1.25 bn. The pre-payments are to be transmitted to Vneshekonombank (Russia), to which Gazprom sold its debts on Naftogaz Ukrainy's corporate bonds. As soon as Vneshekonombank receives the funds, the debt liabilities of Naftogaz Ukrainy will be considered settled.

Real economy: Real GDP grew by 13.5% yoy

From January to July 2004 the real GDP increased by 13.5% yoy. In addition to the continuing high growth rates of value added in manufacturing, trade and construction, the strengthening of the economic performance was due to a recovery in agriculture. A high grain harvest resulted in a 23.7% yoy rise in agricultural value added in the first seven months of the year compared to an almost 30% yoy drop during the same period of 2003. Industrial output grew by 14.7% yoy, mainly due to increased production in machine building, metallurgy, and the food industry. These three sectors contributed 71% of the total growth of the industrial output in the country.

Construction remained one of the most dynamic sectors of the economy. It grew by 26.5% yoy in the first seven months of 2004. Besides increased industrial construction supported by high investment activity, there was growing housing construction. In the first half of the year the volume of housing construction rose by 34.7% yoy, of which only 1% was financed out of state coffers.

Growth of Value Added in Selected Sectors



Source: Derzhkomstat

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Sectoral trends: Ukraine has already harvested 75% more grain than in 2003

Agriculture. By the end of August, Ukraine had harvested 35 m tons of grain, that is 75% more than the previous year's total harvest. Food grain is expected to constitute about 40-45% of the harvest. So far the state has been the only active player on the grain market, intervening and pledging purchases above world market prices. Although the state has announced its intention to buy nearly 3.5 m tons of grain, it has not yet allocated sufficient funds for these purchases. However, despite the high prices, farmers are reluctant to sell grain to state operators. The main reason is that payments from state operators are usually late, which is inconvenient for the producers who need money for their autumn fieldwork. It is anticipated that after the state has completed its purchases, traders will enter the market, causing grain prices to fall later this year.

Infrastructure. In August Ukraine opened the Danube-Black Sea deep-water navigation canal, cutting through a UN-designated environmental reserve. This navigation channel eliminates Romania's monopoly on Danube-Black Sea shipping. The official estimate is that up to 60% of the Danube freight traffic will switch to the Ukrainian canal. At the same time, the EU argues against the use of the canal for ecological reasons.

Privatisation. Upon instruction from President Leonid Kuchma, the privatisation of the 42.86% share packet of Ukraine's largest telecommunications company Ukrtelecom (at a starting price of UAH 2.7 bn) has been halted. The same instruction also stopped the privatisation of 94.54% of the shares of the Odessa Portside Factory, the starting price for which was UAH 0.9 bn. The official reason given was: "recent controversies around the privatisation process in Ukraine". This initiative could reduce the increasing political pressure on the State Property Fund (SPF) on the eve of the elections, and allow the SPF to make the privatisation process more transparent and politically independent after the elections are over.

From January to August 2004 privatization receipts totalled UAH 8.2 bn, exceeding the yearly plan by almost 60%. In August Ukraine sold several important companies, including iron ore mill Kryvorizkiy Zalizorudniy Kombinat purchased by company Solaim (Dnipropetrovsk) for UAH 0.7 bn.

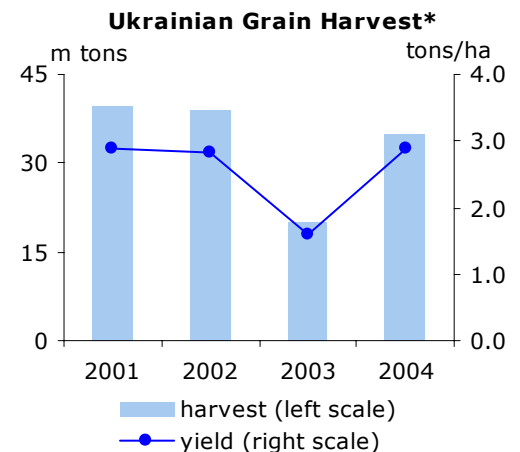
External Sector: Ukraine and Argentina signed the protocol of accession to markets of goods and services

In August Ukraine and Argentina signed a protocol on accession to markets of goods and services, the twenty-fifth protocol within the framework of the WTO membership negotiations. However, Ukraine continues bilateral talks with such important trade partners as the USA, China, Turkey, Japan, among others. At the same time, Ukraine is involved in multilateral talks and is preparing a draft Report of the Working Party, the completion of which represents the final stage of the WTO accession negotiations.

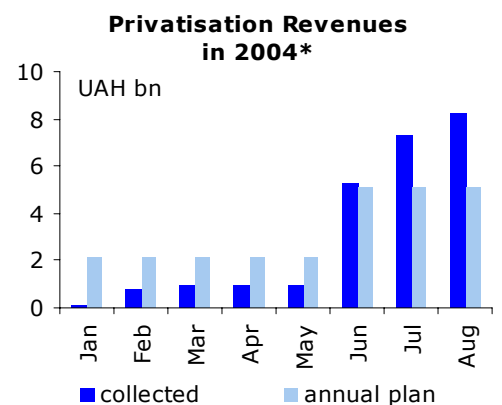
According to Derzhkomstat, exports of goods increased by 50.8% yoy in dollar terms during the first half of the year, while imports grew by 33.0% yoy. As a result, the positive merchandise trade balance reached USD 2.4 bn that is 4.6 times higher than during the same period of 2003. Major exporters continue to be metallurgy, machine building, and the energy sector, while key imports are mineral products, machinery and equipment.

Fiscal policy: The fiscal expenditure execution worsens despite accumulation of UAH 10.6 bn in state accounts

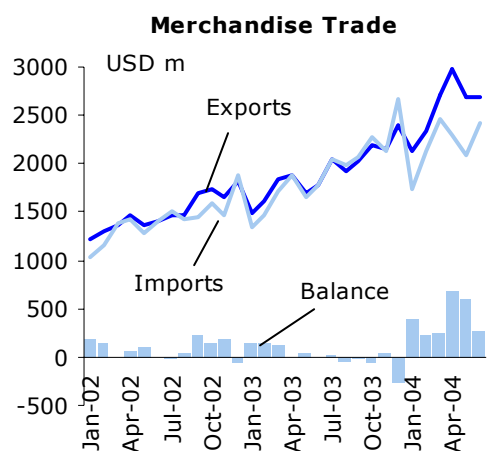
From January to July the execution of central fiscal revenues remained at 102%, the level of the previous period. Favourable macroeconomic conditions resulted in higher than planned revenues from enterprise profit taxes, export duties and excises. At the same time, the execution of fiscal expenditures worsened, reaching only



Sources: Derzhkomstat
* as of beginning of September



Source: State Treasury, State Property Fund
* only general fund of the budget



Source: Derzhkomstat

90% of the projected level. All major functional expenditure groups, except for intergovernmental transfers, were under-executed. The fiscal balance turned from June's deficit to a UAH 70 m surplus.

Higher than expected privatisation receipts and under-execution of the fiscal expenditures allowed UAH 10.6 bn to be accumulated in the state accounts by the end of July. According to the Cabinet of Ministers, additional funds will among others be used to finance transfers to the population and pay wage arrears in the agro-food sector, potentially causing inflationary pressures. However, the Cabinet of Ministers does not foresee any additional transfers to local budgets, needed to finance an increase in the minimum wage. The accumulation of funds in state accounts is not likely to cause interest rates on the inter-bank market to rise, as had happened last year, due to the current high liquidity in the banking sector.

Monetary policy: The NBU continues its policy aimed at suppressing monetary expansion

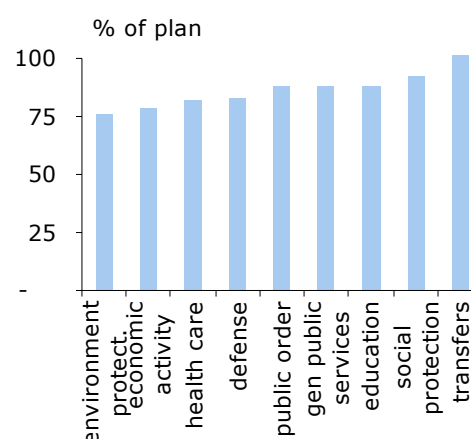
The continuing inflow of foreign currency into the country, combined with a rather flat exchange rate to the US dollar, has led to rapid growth of the money supply. To counterbalance this development, the NBU undertook further steps to suppress monetary expansion. Apart from pursuing a policy of gradual appreciation of the hryvnia with respect to the US dollar, the NBU raised the recently introduced daily minimum requirement for obligatory reserves from 60% to 70% at the end of August. Also, according to a new NBU decree, the reserves requirement ratio will be set at 7% for all types of term deposits and at 8% for demand deposits starting in October. Currently the reserves requirement ratio varies from 0 to 12% depending on the deposit's currency denomination and holder status. This step should markedly increase the amount of funds in the banks' correspondent accounts, and thus should reduce excess liquidity in the banking sector. Bankers claim that the new regulation will raise their expenses and cause interest rate on credits to go up. However, taking into account the current bank liquidity growth, the interest rate increase is likely to be insignificant. Nevertheless, any increase in the reserves requirement is equivalent to higher indirect taxation on the commercial banks, and thus should be substituted by more efficient sterilization instruments.

In August consumer prices grew by 9.9% yoy, although decreasing by 0.1% in mom terms. The monthly decrease is attributed to the seasonal price reductions on agricultural products like potatoes, fruits and vegetables. In addition, the good grain harvest caused a reduction in flour and bread-product prices in August. It is very likely that bread prices will fall yet further over the coming months because of the active state intervention on the market. Although lower bread prices will be beneficial for consumers, producers of bread products will not be able to offset all the losses incurred last year when strict profitability restrictions had been introduced. Furthermore, an administrative reduction of prices may create the risk of an upsurge of inflation after the elections.

Financial markets: Ukraine's domestic government securities became attractive for foreigners

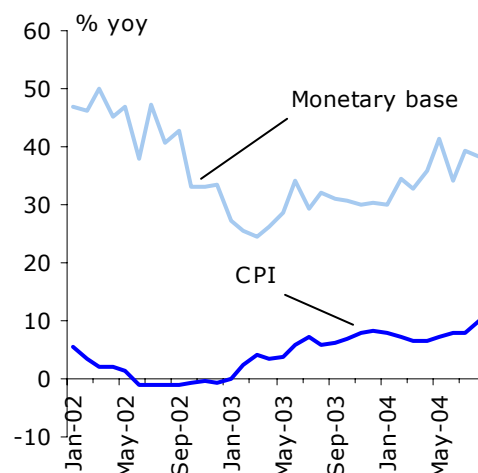
In 2004 the market for domestic government securities is showing signs of revival. For the first time since the 1998 financial crisis have non-residents expressed noticeable interest in Ukraine's domestic state debt market: they already purchased nearly UAH 0.9 bn of the bonds. Between January and June 2004 the Ministry of Finance attracted UAH 2.7 bn through the sale of domestic government bonds in contrast to UAH 1.2 bn for the whole year of 2003. The increase in sales is partly explained by a successful placement of UAH 1.2 bn 5-year VAT bonds, issued for repaying arrears of the state budget on VAT to exporters. The continuing strong economic performance and the recent successful issue of eurobonds may explain the surge of interest in domestic government bonds.

Central Fiscal Expenditures in January-July 2004



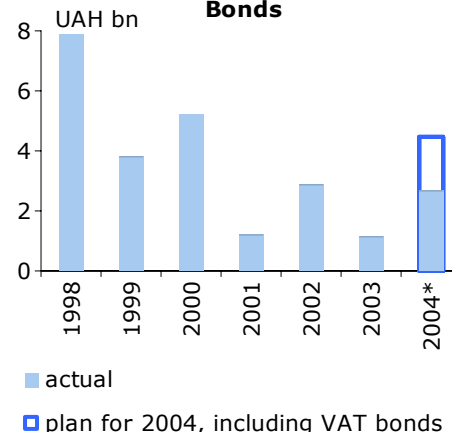
Source: State Treasury

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

Sales of Domestic Government Bonds



Source: Ministry of Finance
* January to June 2004



Economic Trends		Q2 03	Q3 03	Q4 03	Q1 04	Q2 04	Apr	May	Jun	Jul	Aug
GDP growth (real)	% yoy	10.0	6.8	12.1	12.3	...	13.3	10.3	19.1	17.2	...
GDP growth (real)	% yoy cum.	9.2	8.3	9.4	12.3	...	11.5*	11.3*	12.7*	13.5*	...
Industrial production (real)	% yoy cum.	12.4	15.2	15.8	18.8	15.9	17.7	16.9	15.9	14.7	...
Agricultural production (real)	% yoy cum.	-6.0	-16.6	-10.2	-4.0	-1.5	-2.6	-2.7	-1.5	26.5	...
CPI	% yoy eop	5.9	6.2	8.2	6.6	8.0	6.6	7.4	8.0	8.1	9.9
PPI	% yoy eop	5.3	7.4	11.1	18.4	22.4	18.4	20.6	22.4	21.3	22.0
Exports (USD)***	% yoy cum.	23.8	23.7	24.0	38.8	...	49.3"	51.3"	50.8"
Imports (USD)***	% yoy cum.	23.3	25.1	28.7	32.6	...	34.0"	32.5"	33.0"
Merchandise trade balance	USD bn cum.	0.27	0.11	-0.27	0.77	...	1.55"	2.14"	2.41"
Current account	USD bn cum.	1.81	2.48	2.89	1.67	...	x	x	x	x	x
Current account	% GDP, cum.	8.7	7.1	5.9	14.3	...	x	x	x	x	x
Gross international reserves	USD bn eop	6.17	6.68	6.94	7.92	9.63	8.13	8.87	9.63	11.18'	12.27'
Monetary Base	% yoy eop	34.2	31.0	30.2	32.7	34.2	35.9	41.5	34.2	39.2	38.4
Lending rate on UAH credits **	% pa, eop	17.2	18.1	17.9	17.2	16.6	17.2	17.4	16.6	17.0	17.1
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.33	5.33	5.33	5.33	5.32	5.32	5.31
Exchange rate (official)	EUR aop	6.05	6.00	6.34	6.67	6.42	6.40	6.39	6.46	6.53	6.47

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