



# Monthly Economic Monitor Ukraine

- According to the results of the first round of the presidential elections, Viktor Yushchenko was supported by 39.87% of the voters, while Prime-Minister Viktor Yanukovich received 39.32% of the votes.
- Household consumption and exports were the two driving forces for the high GDP growth.
- The merchandise surplus reached USD 3.0 bn between January and August due to high export growth.
- The central fiscal deficit for the period of January to September reached 1.4% of GDP.
- The NBU increased the discount rate by 0.5 p.p. to 8.0% p.a.
- Demand for cash foreign currency is high due to pre-election uncertainty and inflationary expectations.

**No.11 (49)  
November  
2004**

**Population: 48 m**  
**Industry/GDP: 28.8%**  
**Agriculture/GDP: 10.9%**  
**Investment/GDP: 19.1%**  
**Export to: Russia 17%, EU-25 33%**  
**Import from: Russia 35%, EU-25 32%**

## Politics: The first round of Presidential elections is over

On October 31 Ukrainian citizens voted in the first round of the presidential elections. 74.56% of voters turned out to make their choices. The official results of the election were announced on November 10. According to them, Ex-Prime-Minister Viktor Yushchenko was supported by 39.87%, and Prime-Minister Viktor Yanukovich received the support of 39.32%. The third and the fourth candidates, the leftists Oleksandr Moroz (Socialist Party) and Petro Symonenko (Communist Party), got the support of 5.81% and 4.97% of the votes each. The election results might be contested in the courts. Since no candidate secured 50% of the votes or more, a second round of elections is scheduled for November 21.

While observers from CIS countries stated that they didn't find any violations that would have changed the election results, observers from PACE evaluated the election campaign in Ukraine negatively, pointing to numerous violations, especially significant irregularities with the voters' list.

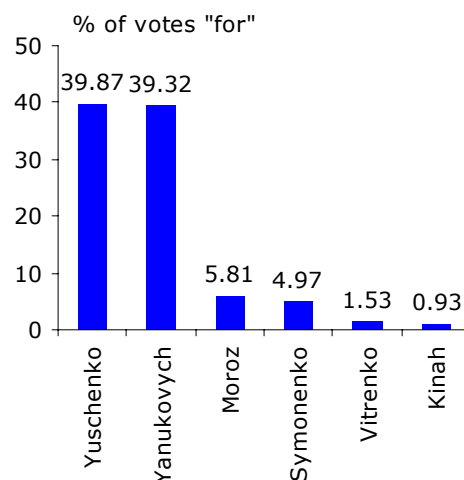
## Real economy: Private consumption and exports are two key factors of the GDP growth

According to Derzhkomstat, the real GDP growth rate for the first half of the year was 12.8% yoy. Increased final household consumption (15.8% yoy) was the main source of demand in the economy and thus the main contributor to growth, while state consumption declined by 2.7% yoy in real terms. Gross fixed capital accumulation grew by 12.1% yoy during the first six months of 2004, significantly decelerating compared to the first quarter. This slowdown might be explained by a redirection of funds towards wages and repayment of social arrears on the eve of the election. External demand was the second key factor for economic growth. In real terms, the exports of goods and services grew by 15.8% yoy, while imports increased by 10.5% yoy.

The real GDP growth grew by 13.4% yoy during the first nine months of the year, still backed by growth in manufacturing, agriculture, trade, and construction. Industrial output increased by 14.4% yoy, mainly due to high growth rates in machine building and metallurgy.

The positive developments in the economy were also reflected in reductions of overdue payables and receivables. As of the beginning of September 2004, overdue receivables dropped by 9.3% yoy, while overdue payables declined by 11.0%, indicating better payments discipline in the economy. At the same time, general receivables and payables have grown steadily, likely because of an extensive use of trade credit arrangements in the absence of sufficient bank intermediation.

**Voting Results of the First Round of Presidential Elections\***



Source: Central Election Commission

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## Sectoral trends: The first section of the Kyiv-Odesa highway started operation

**Infrastructure.** The first section of the Kyiv-Odesa highway between Zhashkiv and Chervonoznamianka was opened in October after a two-month delay. However, the construction of this section is not yet fully completed, it still needs to be covered with an additional layer of asphalt next spring. The road will be toll-free until an alternative road is built. In sum, one of the largest road construction projects failed to be completed on time.

The state railway monopoly Ukrzaliznytsia has received a USD 0.7 bn loan from Deutsche Bank for construction of an auto-railway bridge over Dniپر River in Kyiv, to be opened in early 2006. The state provides a guarantee for this loan, thus increasing indirect state debt. Earlier in October the EBRD granted a USD 100 m loan for refurbishing the Kyiv-Chop Highway (M06) to meet European standards, and for further reform of the road sector administration and financing.

**Privatisation.** The Ukrainian government has increased its estimate of privatization receipts for 2004 to UAH 9.3 bn, due to the October announcement to tender for the big mining complex "Krasnodonvuhillia", for which the State Property Fund expects to raise UAH 1 bn. The Cabinet of Ministers transferred the management of the 92.86% state shares in the telecommunications company "Ukrtelecom" to the State Property Fund. This decision allows concentrating all state property rights management in one office, which should improve the integrity of state's economic policy.

### External Sector: The trade surplus reached USD 3.0 bn

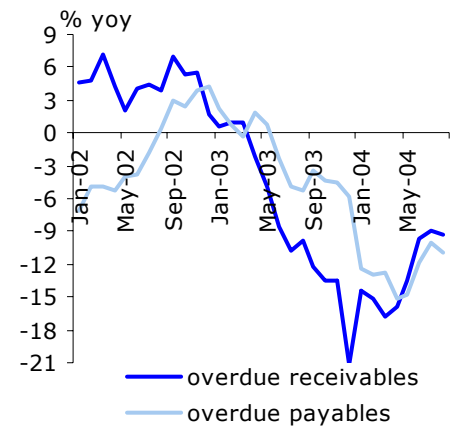
According to Derzhkomstat, the export of goods grew by 47.7% yoy, while imports increased by 34.2% yoy in dollar terms during the first eight months of the year. The trade surplus reached USD 3.0 bn, which is USD 2.6 bn higher than in the same period of the previous year. As before, metallurgy has remained the major source of export receipts growth, contributing 42% to the total exports increase. Another 27% of exports growth is explained by sales of the machine-building industry's products. Growth in mineral products imports to a large extent determined by increased prices contributed 38% to total imports growth. Investment demand for machinery and equipment added another third to the imports increase.

The Government continues to use non-tariff measures as instruments for solving pressing domestic problems. Responding to rising meat prices in the country, the Cabinet of Ministers introduced export licensing of meat. Although called a "monitoring" measure, it will likely increase the transaction costs of exporters, thus reducing their incentive to sell abroad. As a result, the proposed measure may reach its ultimate goal of helping to slow price growth, while distorting market stimuli. The better option would have been not to restrict exports, but to liberalise imports, a step the Government took later this month.

### Fiscal policy: The fiscal deficit reached 1.4% of GDP

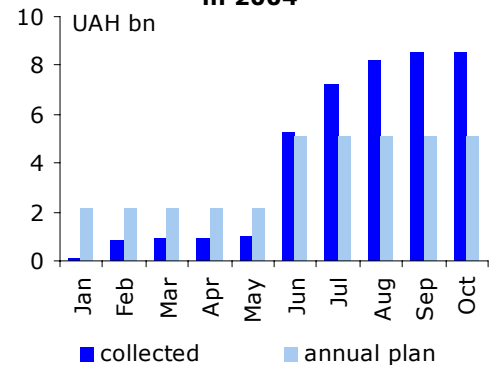
From January to September, the central fiscal revenues were executed at 101%. Over-execution of the majority of taxes, including the EPT with an execution rate of 112%, was offset by under-execution of the VAT. The VAT was 9% below target partly due to the high export growth. For the same period, the expenditures reached only 91% of plan. While the average execution rate of expenditures (without intergovernmental transfers) was 88%, the central state transfers to local budgets reached 106% due to good receipts for those taxes, which are allotted to these transfers. The resulting central fiscal deficit reached UAH 3.4 bn, or 1.4% of GDP.

### Enterprise Overdue Receivables and Payables



Source: Derzhkomstat

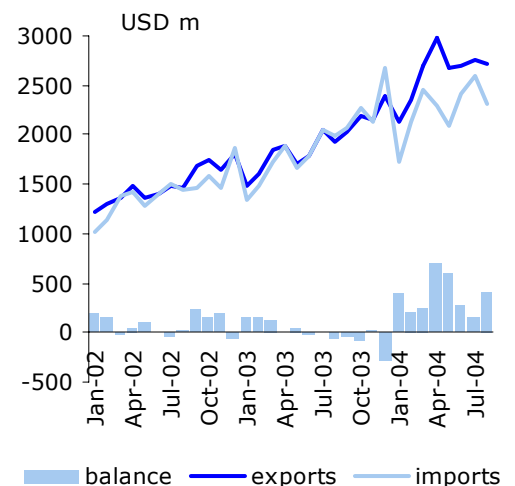
### Privatisation Receipts in 2004\*



Source: State Treasury

\* only general fund of the budget

### Merchandise Trade



Source: Derzhkomstat

Parliament failed to approve the draft budget for 2005, returning it to the Budget Committee and the Government with proposals for modifications. Among others, the Budget Committee had proposed to increase the central fiscal revenues by UAH 2.7 bn to UAH 90.5 bn by setting higher rates for nearly all types of rent payments, excises, and import duties, thus imposing an additional burden on the economy. On the expenditure side, the proposed increases of transfers to the population are also undesirable. The draft budget contains some revenue risks that could lead to a fiscal shortfall, and extra expenditures might require foreign borrowing, thus accumulating macroeconomic risks. Furthermore, sharp increases in these transfers might cause further inflationary pressure.

**Social policy: Unemployment is declining**

The unemployment rate, determined according to the International Labour Organisation methodology, dropped from 9.8% to 9.3% during the first half of the year. This reduction is mainly explained by an increasing demand for both skilled and unskilled labour caused by the strong economic growth. The average wage grew by 21% yoy in real terms from January to September, further prompting unemployed to search for jobs. A further decline in unemployment can be expected, based on the economic growth forecast, and the absence of restructuring that could provoke layoffs.

**Monetary policy: The NBU increased its discount rate**

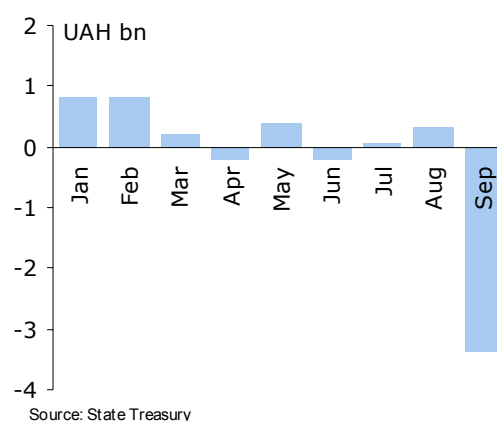
The National Bank of Ukraine has raised its discount rate in October by 0.5 percentage points to 8.0% p.a. This was done in response to the forward dynamics of the monetary aggregates during the last months, but could also reflect that the NBU envisions inflationary threats. The discount rate increase should raise the interest in government VAT-bonds, which have their profitability tied to this rate. The increase in the discount rate is not likely to have significant effects on the banking liquidity in the short run, since it seems to be the least effective instrument of the NBU monetary policy.

In October consumer prices grew by 11.7% yoy, accelerating compared to September. Active administrative interventions on the meat market, including control over prices by the militia and the office of the public prosecutor, and introduction of markup restrictions for meat and meat products, have slowed the growth of prices. At the same time, prices increased for milk, butter, sunflower oil, fruits and vegetables. The large social payments introduced in September are likely to continue creating inflationary pressure on the food market.

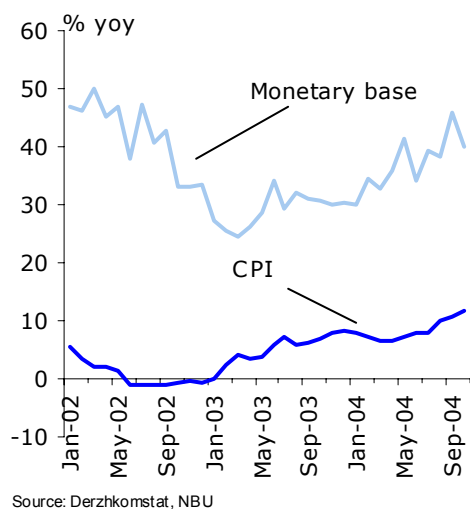
**Financial markets: Demand for cash foreign currency still outweighs supply**

**Foreign exchange market.** The October demand for US dollars on the foreign cash market continued to outweigh supply. The bid-rate for cash US dollar stood at 5.38–5.42 UAH/USD, whereas the official rate appreciated slightly to 5.31 UAH/USD by the end of October. The high demand for foreign cash is caused primarily by the rising political uncertainty in the pre-election period and inflationary expectations provoked by the recent sharp growth of prices for food products. To prevent a shortage of foreign cash, the NBU started selling cash US dollars to the commercial banks, already putting USD 420 m on the market at the fixed rate of 5.315 UAH/USD. At the same time, the NBU introduced an administrative 2% restriction on the spread between the banks' cash rates and the official exchange rate. However, these measures were unsuccessful, since the banks are reluctant to sell foreign cash, provoking further shortages and, as a result, black market activities. Still, taking into account the high level of international reserves accumulated by the NBU, the monetary authorities are likely to re-establish exchange-rate stability at the cash market by the end of 2004.

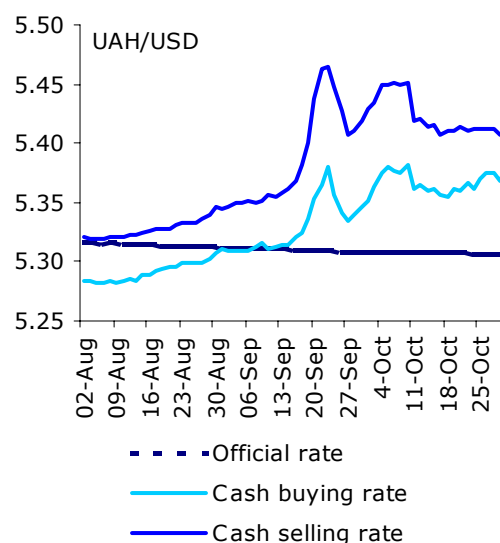
**Central Fiscal Balance 2004**



**CPI and Monetary Base Development**



**UAH/USD Exchange Rate**





<b>Economic Trends</b>		<b>Q2 03</b>	<b>Q3 03</b>	<b>Q4 03</b>	<b>Q1 04</b>	<b>Q2 04</b>	<b>Jun</b>	<b>Jul</b>	<b>Aug</b>	<b>Sep</b>	<b>Oct</b>
GDP growth (real)	% yoy	10.0	6.8	12.1	12.3	13.2	19.1	17.2	14.2	11.5	...
GDP growth (real)	% yoy cum.	9.2	8.3	9.4	12.3	12.8	12.7*	13.5*	13.6*	13.4*	...
Industrial production (real)	% yoy cum.	12.4	15.2	15.8	18.8	15.9	15.9	14.7	14.4	14.4	...
Agricultural production (real)	% yoy cum.	-6.0	-16.6	-10.2	-4.0	-1.5	-1.5	26.5	32.1	24.8	...
CPI	% yoy eop	5.9	6.2	8.2	6.6	8.0	8.0	8.1	9.9	10.7	11.7
PPI	% yoy eop	5.3	7.4	11.1	18.4	22.4	22.4	21.3	22.0	23.2	24.3
Exports (USD)***	% yoy cum.	23.8	23.7	24.0	38.8	42.7	50.8"	48.0"	47.0"	...	...
Imports (USD)***	% yoy cum.	23.3	25.1	28.7	32.6	29.6	33.0"	32.1"	29.9"	...	...
Merchandise trade balance	USD bn cum.	0.27	0.11	-0.27	0.77	2.23	2.41"	2.56"	2.96"	...	...
Current account	USD bn cum.	1.81	2.48	2.89	1.67	4.01	x	x	x	x	x
Current account	% GDP, cum.	8.7	7.1	5.9	14.3	15.5	x	x	x	x	x
Gross international reserves	USD bn eop	6.17	6.68	6.94	7.92	9.63	9.63	11.14	12.25	12.16'	10.7'
Monetary Base	% yoy eop	34.2	31.0	30.2	32.7	34.2	34.2	39.2	38.4	45.7	40.0
Lending rate on UAH credits **	% pa, eop	17.2	18.1	17.9	17.2	16.6	16.6	17.0	17.1	17.0	17.3
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.33	5.33	5.32	5.32	5.31	5.31	5.31
Exchange rate (official)	EUR aop	6.05	6.00	6.34	6.67	6.42	6.46	6.53	6.47	6.48	6.62

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).

<b>Key Economic Indicators</b>		<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
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.

**avg** average

**cum.** cumulative

**mom** month on month change

**qoq** quarter on quarter change

**yoy** year on year change

**p.a.** per annum

**eop** end of the period

**aop** average of the period

**gs** goods and services