



Monthly Economic Monitor Ukraine

- Pervasive violations during the second round of the presidential elections resulted in a severe political crisis.
- Parliament passed a vote of no-confidence in the government.
- The real GDP growth slowed to 12.7% yoy for the first ten months of the year.
- Parliament extended the moratorium on agricultural land sales and purchases.
- The fiscal deficit reached UAH 6.4 bn despite the under-execution of expenditures.
- The NBU simplified the access to refinancing credits for banks reacting on a reduction of liquidity in the banking system.
- To preserve the stability of the banking system, the NBU issued a temporary regulation to reduce the commercial bank activity and to prohibit pre-term repayments of time deposits.

No. 12 (50)
December
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: Political crisis in Ukraine

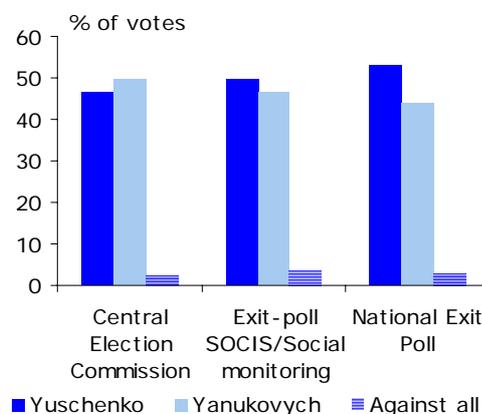
On November 21 Ukrainian citizens voted in the second round of the presidential elections, choosing between two candidates: Viktor Yushenko and Viktor Yanukovich. According to the results announced by the Central Election Commission, Viktor Yanukovich received 49.46% of the votes, and Viktor Yushenko 46.61%. These results contradicted exit polls conducted by independent agencies. Viktor Yushenko's side protested the results of the election at the Supreme Court claiming massive and systematic violations of the law, which made it impossible to determine the will of voters in the second round of elections. Parliament adopted a resolution, stating that it did not recognize the results declared by the Central Election Commission. The USA, Canada, the EU and other countries voiced their concerns about the voting irregularities and refused to recognise the officially announced result. However, Belarus, Russia, and China, among others, recognized the elections as fair and congratulated Mr. Yanukovich for his victory. Later Parliament passed a no-confidence vote in the government headed by Mr. Yanukovich, which should have been followed by the President of Ukraine relieving the current prime minister of his duties. Mass peaceful protests on the streets of Kyiv blockaded the major central government buildings, such as the Cabinet of Ministers and the Presidential Administration. The competing candidates have come to a stalemate, causing European negotiators to become involved.

Following the presidential elections officials in Donetsk, Luhans and Kharkiv oblasts recognized Mr. Yanukovich as the president, while the western and central oblasts refused to do so. Officials in the three above-mentioned oblasts voiced separatist sentiments and threatened with conducting referenda on separating from Ukraine or on creating an autonomous South-Eastern Republic within Ukraine, should Mr. Yushenko become the president. The mayor of Moscow Yuri Luzhkov came to Siverodonetsk City to speak to the congress of local council deputies to support them in their separatist leanings. The Siverodonetsk gathering was also attended by Mr. Yanukovich. Later on, once the Security Service of Ukraine and the Prosecutor General opened criminal cases for threatening state unity, most of the officials withdrew their remarks, although continuing to maintain their separatist stance with subtle threats.

The real economy: The GDP growth decelerates

According to Derzhkomstat, the real GDP grew by 12.7% yoy during the first ten months of the year, decelerating compared to the nine-months figure. In line with expectations, the agricultural growth rate slowed down after the end of harvesting period. Also, from January to October industrial output decelerated to 13.6% yoy, partially due

Results of the second round of elections



Sources: Central Election Commission,
www.exitpoll.org.ua

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to a statistical base effect. Lower growth rates were observed in almost all industries, including such core manufacturing sectors as metallurgy, machinery building and the food industry.

The political crisis accompanied by serious social unrest and strikes is likely to dampen the rate of economic growth in Ukraine in November and December. It is expected that the political instability will cause the growth of the real GDP to decelerate by several percentage points compared to the forecast of 12.8% for 2004.

Sectoral trends: Parliament extended the moratorium on agricultural land sales and purchases

Agriculture. The Verkhovna Rada overrode the President's veto of the law postponing the moratorium for sales and purchases of agricultural land until January 1, 2007. Before the vote, the moratorium would have expired on January 1, 2005. Also, the moratorium on ownership (excluding inheritance) of agricultural land above 100 ha was extended by five years until 2015. Although these steps seem to stray from market-oriented principles, the lack of any legal framework for servicing land sales and purchases may justify this decision.

Privatisation. Privatization receipts have netted UAH 9.3 bn between January and November 2004. The principal part of the November revenues resulted from the sale of the 60% share of the big mining complex "Krasnodonvuhillia" for UAH 770.3 m, which was tendered in October. The winning bidder is the joint stock company Avdeevsky Coke-Chemical Plant controlled by System Capital Management (Donetsk). The new owner promised to invest UAH 1 bn in the capital stock of the acquired enterprise over the next five years. The Government directed the additional privatisation receipts towards payments to pensioners.

External Sector: A positive trade balance of USD 3.2 bn

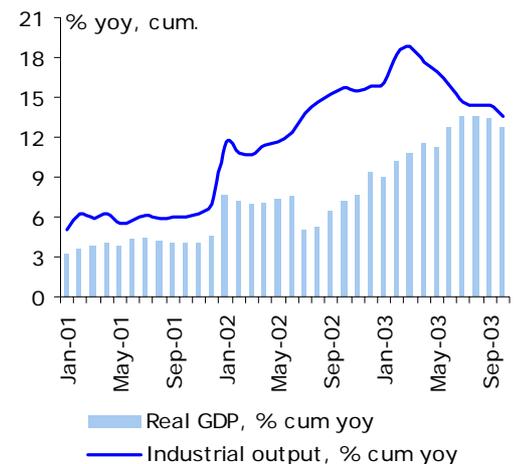
According to Derzhkomstat, exports of goods in dollar terms increased by 46.0% yoy during the first nine months of 2004, while imports grew by 29.6% yoy. The positive balance of trade in goods reached USD 3.2 bn. The EU has continued to be Ukraine's largest export partner, after enlargement purchasing 30.0% of the country's exports. Russia has possessed the second position absorbing 17.9% of the total exports. From January to September exports to the EU increased by 37.7% yoy, while exports to Russia grew by 40.0% yoy. For imports Russia has remained the largest trading partner, mainly by supplying Ukraine with energy materials. Imports from the EU, the key components of which are investment goods, figure in second place. During the first nine months imports from Russia increased by 38.6% yoy, while imports from the EU grew by 23.4% yoy.

Fiscal policy: The fiscal deficit reached UAH 6.4 bn

From January to October the central fiscal revenues were received at the planned level. Higher than planned collections of the enterprise profits tax and of revenues from international trade allowed to offset lower VAT collections. For ten months, the central fiscal expenditures were executed at the level of 95%, reflecting the tendency of previous years to increase fiscal expenditures only at the end of the year. The central fiscal deficit reached UAH 6.4 bn.

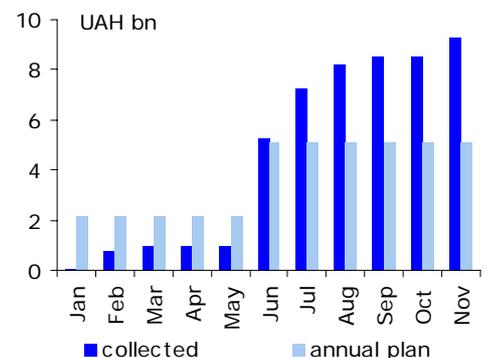
The political situation in the country may result in a fiscal unbalance. Uncertain business relations with foreign partners, and thus, broken international contracts might affect the fiscal revenues from international trade, namely VAT from imported goods and excise paid at the border. In the future, further reductions in the enterprise profits tax and VAT receipts are expected. The reduction of these revenues is lagged due to the tax calendar. On the expenditure side, the delay in the budget process for 2005 may result in under-execution of expenditures, since the government will start to hold back funds expecting uncertain cash flows next year. This behaviour may worsen the liquidity situation in the banking system. If the

GDP and Industrial Output



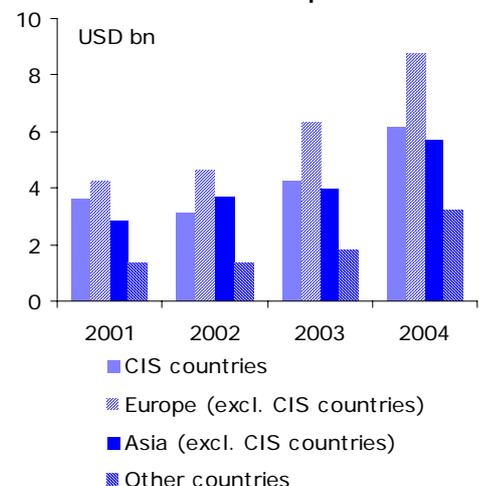
Source: Derzhkomstat

Privatisation Receipts in 2004*



Source: State Treasury
* only general fund of the budget

Regional Distribution of Merchandise Exports*



* data from January to September of a respective year
Source: Derzhkomstat

Budget 2005 is adopted before the end of the year, large fiscal expenditures, which were non-executed in budget 2004 in time, can be expected in the first half of January 2005, causing additional inflationary pressure.

Social policy: Wage arrears are paid from the budget

In October the average wage was UAH 636 per month, growing by 16.1% yoy in real terms. The highest wage levels were in the Kyiv City, and Donetsk, Dnipropetrovsk, Zaporizhzhya and Luhansk oblasts. However, the Donetsk, Luhansk and Dnipropetrovsk oblasts also faced the largest wage arrears, mainly concentrated in the mining sector. These three oblasts accounted for more than 55% of all wage arrears in Ukraine. To solve the problem, in September the Cabinet of Ministers permitted wage arrear repayments to be made out of central fiscal funds. Although this measure indeed resulted in a one-fifth reduction in arrears during the month, such an approach discourages future wage discipline and stimulates a rent-seeking behaviour by enterprises.

Monetary policy: The NBU simplified banking access to refinancing credits

Starting in the first half of November the liquidity of the banking sector reduced rapidly as evidenced by quickly rising interest rates on interbank credits. Initially, the shortage of liquidity was caused by a high demand for foreign currency, satisfied by NBU sales of international reserves to commercial banks. As a result, the gross reserves declined by USD 0.9 bn to USD 9.9 bn during November. The political crisis aggravated the liquidity problem, because customers started to withdraw bank deposits. These reasons explain the deceleration of the money supply growth rate to 42% yoy by the end of November. The NBU reacted to the liquidity shortage by simplifying the access to refinancing credits for banks and supplying more liquid resources to the banking system, although leaving the discount rate unchanged after increasing it in early November.

At the beginning of November the NBU increased all its interest rates, including the discount rate, which rose from 8% p.a. to 9% p.a. Bankers claimed that this measure had no effect on the banking sector, since it just reflected the increase in the banks' credit rates.

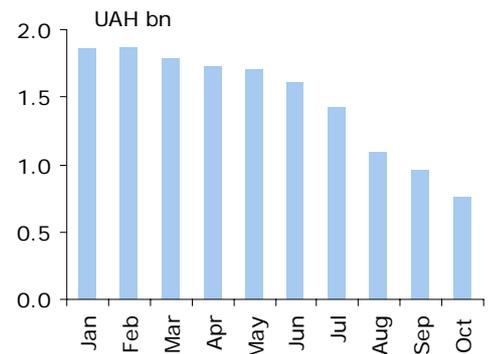
According to Derzhkomstat, consumer prices grew by 11.3% yoy in November. The high political uncertainty in the country contributed to the intensification of inflationary expectations that may lead to a significant acceleration of inflation in December should the political instability continue beyond the immediate future.

Financial markets: Temporary prohibition of pre-term repayments of time deposits

Banking sector. The Ukrainian banking system was severely affected by the political crisis in November. This was mainly reflected in the outflow of deposits, foremost household deposits, which decreased by UAH 2.2 bn within a month. To prevent a further rush by bank clients, which could lead to liquidity problems in the banking sector, the NBU introduced several temporary administrative measures. Firstly, it confirmed its readiness to maintain sufficient liquidity in the banking sector by refinancing means and further allocations of deposit certificates. Secondly, it prohibited pre-term repayment of time deposits of households and legal entities. Also, it limited the withdrawal of cash funds to UAH 80,000 per month from legal entity accounts, and to UAH 1,500 per day from cash points. These regulations are seen as adequate in the current situation, and further stabilization is expected once the political crisis is resolved.

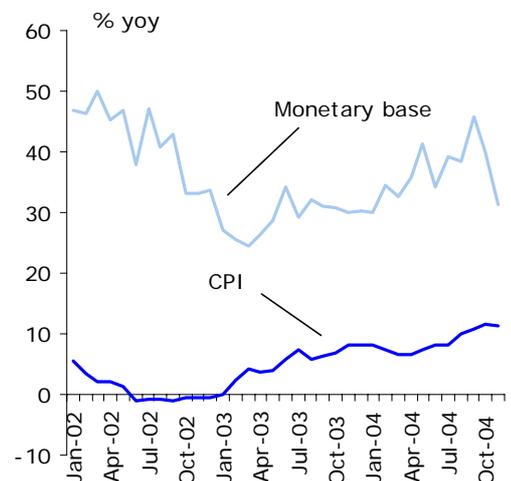
Financial markets. The international rating agency Moody's reduced Ukraine's rating on foreign currency liabilities from "positive" to "developing". This step reflects the rising risks in the country caused by the political crisis. However, the rating may be restored to the previous level, if the political crisis is quickly resolved.

Wage arrears in 2004



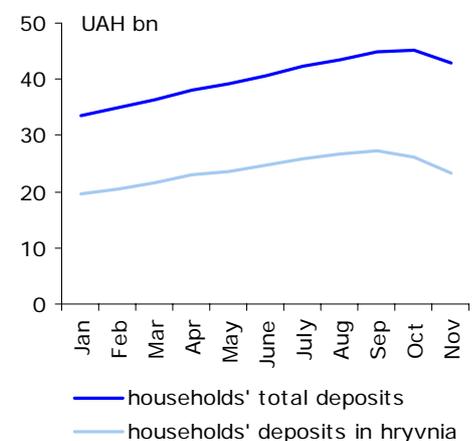
Source: Derzhkomstat

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

Households' deposits in 2004



Source: NBU



Economic Trends		Q3 03	Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Jul	Aug	Sep	Oct	Nov
GDP growth (real)	% yoy	6.8	12.1	12.3	13.2	...	...	17.2	14.2	11.5	7.6	...
GDP growth (real)	% yoy cum.	8.3	9.4	12.3	12.8	...	...	13.5*	13.6*	13.4*	12.7*	...
Industrial production (real)	% yoy cum.	15.2	15.8	18.8	15.9	14.4	...	14.7	14.4	14.4	13.6	...
Agricultural production (real)	% yoy cum.	-16.6	-10.2	-4.0	-1.5	24.8	...	26.5	32.1	24.8	19.6	...
CPI	% yoy eop	6.2	8.2	6.6	8.0	10.7	...	8.1	9.9	10.7	11.7	11.3
PPI	% yoy eop	7.4	11.1	18.4	22.4	23.3	...	21.3	22.0	23.2	24.3	25.2
Exports (USD)***	% yoy cum.	23.7	24.0	38.8	42.7	...	...	48.0"	47.0"	46.0"	...	...
Imports (USD)***	% yoy cum.	25.1	28.7	32.6	29.6	...	...	32.1"	29.9"	29.6"	...	...
Merchandise trade balance	USD bn cum.	0.11	-0.27	0.77	2.23	...	...	2.56"	2.96"	3.15"	...	...
Current account	USD bn cum.	2.48	2.89	1.67	4.01	...	...	x	x	x	x	x
Current account	% GDP, cum.	7.1	5.9	14.3	15.5	...	...	x	x	x	x	x
Gross international reserves	USD bn eop	6.68	6.94	7.92	9.63	12.16'	...	11.14	12.25	12.16'	10.83'	9.90
Monetary Base	% yoy eop	31.0	30.2	32.7	34.2	45.7	...	39.2	38.4	45.7	39.9	31.2
Lending rate on UAH credits **	% pa, eop	18.1	17.9	17.2	16.6	17.0	...	17.0	17.1	17.0	17.3	17.8
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.33	5.31	...	5.32	5.31	5.31	5.31	5.31
Exchange rate (official)	EUR aop	6.00	6.34	6.67	6.42	6.49	...	6.53	6.47	6.48	6.62	6.88

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	p.p.	percentage points
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