

Monthly Economic Monitor Ukraine

- The re-run of the second round of presidential elections resulted in 51.99% of the votes being cast for Viktor Yushchenko vs. 44.19% for Viktor Yanukovich.
- The real GDP grew by 12.4% yoy from January to November, decelerating steadily.
- Privatisation receipts in 2004 reached UAH 9.6 bn.
- Ukraine signed another 5 protocols on accessions to goods and services markets within the framework of the WTO negotiations.
- The State Budget for 2005 was adopted with a deficit of 2.1% of GDP.
- Consumer prices increased by 12.3% eop in 2004.

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Politics: Viktor Yushchenko leads in the re-run of the second round of elections

On December 26 Ukraine voted in a repeated second round of the presidential elections choosing between Viktor Yushchenko, leader of the parliamentary faction "Our Ukraine", and Viktor Yanukovich, the Prime Minister. According to results announced by the Central Election Committee (CEC), Mr. Yushchenko received 51.99% of the votes and Mr. Yanukovich 44.20%. The re-run of the second round was preceded by unprecedented mass protests in Ukraine in late November and early December, the so-called "Orange revolution". Hundreds of thousands of protesters were in the streets of Kyiv and other Ukraine's cities for several weeks, proclaiming their rights to free and honest elections. The Supreme Court eventually found that the second round of elections was flawed, and ordered the CEC to repeat the second round of the elections as demanded by the Yushchenko side.

Mr. Yanukovich took a vacation during the "third" presidential round and requested to be allowed to resign from the position of Prime Minister on December 31. After it became clear that the elections would not be in his favour, he turned to the Supreme Court with submissions complaining that there had been numerous violations during the "third" round of elections and that it should be cancelled. However, so far the Court has rejected all these complaints. It is expected that Mr. Yushchenko will be inaugurated in mid-January, once all the complaints have been reviewed and the CEC has issued its official statement of the results.

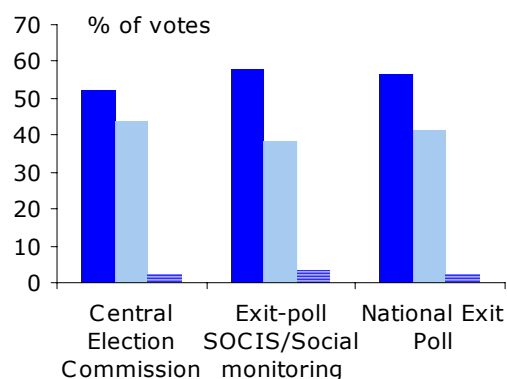
The imminent fall of the currently ruling regime has already led to resignations. The Prosecutor-General, Gennadij Vasiljev, the Head of the NBU, Serhiy Tihipko, and other figures actively involved in the Yanukovich campaign resigned or were fired by Leonid Kuchma. The new Prosecutor-General, Svjatoslav Piskun, and the new Head of the NBU, Volodymyr Stelmakh, who had previously occupied these positions, were reconfirmed in them by Leonid Kuchma. The Minister of Transport and Communications, Heorhiy Kirpa, was found dead in his villa with a bullet wound in his head. An investigation was opened as a "driven to suicide".

Real economy: The real GDP growth gradually slowed

The gradual deceleration of economic growth continued in November. According to preliminary Derzhkomstat estimates, the real GDP increased by 12.4% yoy during the first eleven months that is 0.3 percentage points less than the ten-month figure. Lower growth rates in industry, construction and trades, as well as the seasonal slowdown in agriculture caused this deceleration. The political instability during November-December also added to the slower GDP growth, however its precise impact will be evaluated once all the statistical information becomes available. It is expected that the real GDP growth in 2004 will be 12%.

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

**Re-run of second round of elections
on December 26**



■ Yushchenko ■ Yanukovich ■ Against all

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

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According to Derzhkomstat, the real GDP grew by 13.4% yoy during the first nine months of 2004, reflected by high final households consumption (15.7% yoy) and external demand (12.3% yoy). The growth rate of state consumption remained negative for three quarters in a row. During the third quarter the gross fixed capital accumulation increased by 6.1% yoy, although the nine-month rise of 9.6% yoy is lower than it was for the same period last year. This deceleration of gross fixed capital accumulation could be explained by a lower availability of funds for investment activities on the eve of the elections.

Sectoral trends: The privatisation receipts reached a historical maximum of UAH 9.6 bn in 2004

Privatisation. In 2004 the privatisation receipts amounted to UAH 9.6 bn, the highest level since privatisation was started. The principal contribution derived from the sales of the metallurgical enterprise "Kryvorizhstal" (UAH 4.3 bn), the ore mining and processing enterprise "Ukrudprom" (about UAH 1.4 bn), and the mining complexes "Pavlogradvuhillia" (UAH 1.4 bn) and "Krasnodonvuhillia" (UAH 0.8 bn). It is expected that the 2005 privatisation receipts will total UAH 4.9 bn. These receipts should enable the government to finance its high social obligations.

Agriculture. In December the Verkhovna Rada prolonged the VAT exemptions for milk and meat producers and processors till January 1, 2006. This step continues the inefficient practice of indirect sector subsidization. The same law also introduced separate social payments for payers of the fixed agricultural tax: In 2005 and 2006 they are to pay 6.4% of wages into the state mandatory pension insurance. Thereafter this fee will increase by 6.4 percentage points annually until it reaches the economy-wide level, fixed at 32%. Although this decision introduces an additional tax burden on farmers, it partially equalizes the social tax burden among all economic agents.

External Sector: Ukraine signed 5 more protocols within the framework of WTO negotiations

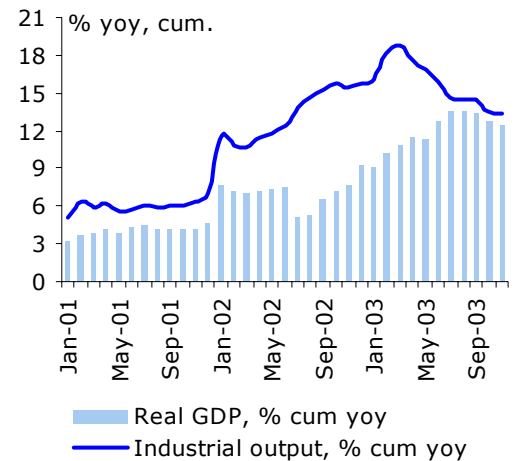
In November and December Ukraine signed 5 protocols on accession to markets of goods and services within the framework of the WTO membership negotiations. Protocols were signed with Turkey, Mongolia, Sri Lanka, Honduras and the Dominican Republic. The total number of protocols now stands at 30, ten of which were signed in 2004. Ukraine continues bilateral negotiations with the USA, Norway, Japan, China, and Australia among others. Ukraine also conducts multilateral talks on preparation of the final Working Party Report. Unresolved questions include technical barriers, customs evaluations, tax privileges, export tariffs, export and import quotas on sugar. The authorisation of the Cabinet of Ministers to change tariffs and set minimum customs values, envisaged in the 2005 Budget Law, may significantly complicate negotiations, since this contravenes the WTO rules.

According to the NBU, the current account surplus reached USD 5.8 bn in the first nine month of 2004 due to the high positive balance in goods and services, as well as continuing high current transfers. From January to September exports of goods increased by 45.1% yoy in dollar terms, while imports grew by 28.7% yoy. The inflow of foreign direct investments into Ukraine reached USD 1.3 bn that is 36.0% higher than for the same period of the previous year.

Fiscal policy: The State Budget for 2005 was adopted with a deficit of UAH 8.6 bn

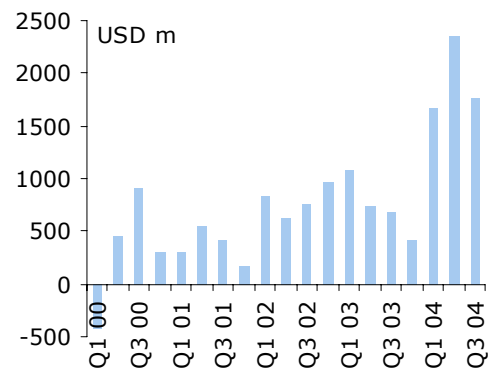
The State Budget for 2005 was adopted by Parliament and signed by the President in late December 2004. The budget is based on a realistic macroeconomic scenario, envisaging 6.5% real GDP growth. Its revenues and expenditures are planned at the levels of UAH 86.5 bn and UAH 95.5 bn respectively. Also, the government expects to

GDP and Industrial Output



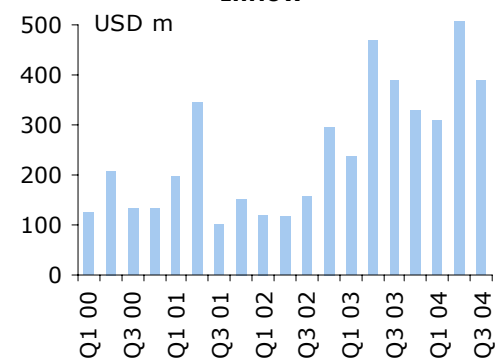
Source: Derzhkomstat

Current Account Balance



Source: NBU

Foreign Direct Investments Inflow



Source: NBU

receive UAH 0.4 bn as repaid credits. Thus, the planned deficit is UAH 8.6 bn (2.1% of GDP), significantly higher than in previous years, which poses the problem of fiscal sustainability, i.e. the government's ability to finance recurrent expenditures in the future. Budget-2005 envisages increases in the minimum wage and consequently other wages, additional Pension fund transfers, and increased expenditures for social protection. The major problems inherited by Budget-2005 include non-transparent procedures of budget settlements and amendments to other laws to meet the needs of the current budget. Moreover, the absence of clearly stated goals and programs resulted in continuing high state aid directed at agriculture and coal mining.

The central fiscal execution from January to November was affected by the political events. The revenues were under-executed at 98% mainly due to a 19% under-performance of VAT. At the same time the fiscal expenditures increased to 96.4% of budget. Thus, the fiscal deficit reached UAH 7.8 bn or nearly 2.6% of GDP.

Social policy: The State Budget earmarks funds for paying social aid to pensioners

According to the State Budget for 2005, the fiscal transfer to the Pension Fund will be UAH 12 bn. Half of this amount (UAH 6 bn) is earmarked for paying the social aid to pensioners introduced in September 2004. The remaining transfer will be used to compensate for the reduced insurance contributions from farmers eligible for a fixed agricultural tax (UAH 1.2 bn), to compensate for the higher pensions to workers employed in underground mines (UAH 0.7 bn), and to finance other state pension programs. At the same time, the Budget Law envisages increased Pension Fund revenues. The upper wage limit for contributions to the compulsory insurance funds was increased from UAH 2660 to UAH 4100. This decision allows the Pension Fund to receive higher revenues, although this noticeably increases the labour costs of entrepreneurs.

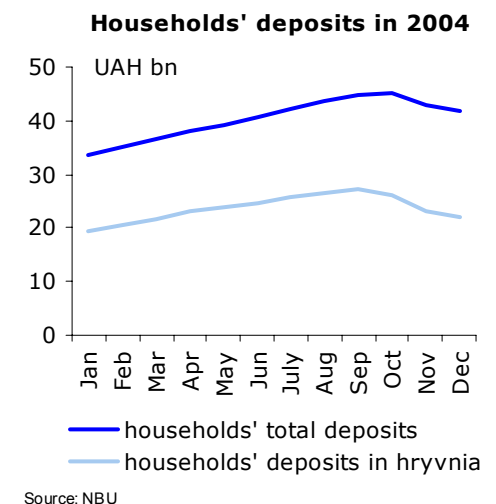
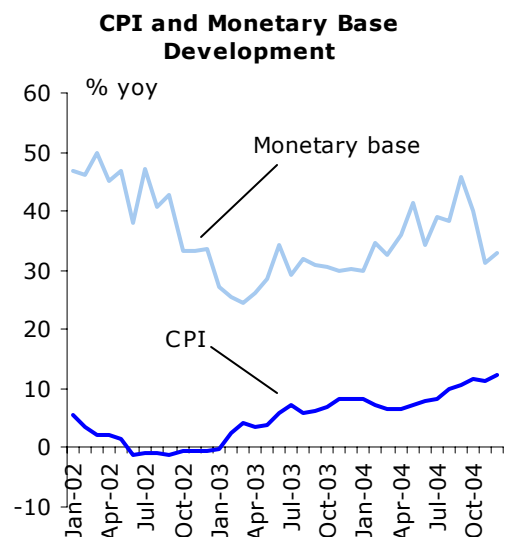
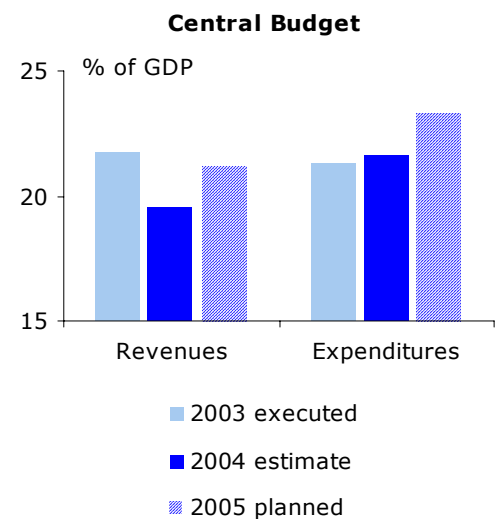
Monetary policy: The annual growth of the monetary aggregates slowed due to the political crisis

In contrast to the September projections of the NBU Council, the 2004 growth of the monetary base dropped to the more modest rate of 34%. The slowdown was caused by the uncertainties related to the elections that resulted in withdrawals of bank deposits, increased foreign currency demand and capital outflow, all taking place during the last two months of the year. The NBU supplied standard refinancing loans and stabilization credits to the banking sector in order to alleviate the liquidity problems of some banks.

In line with our forecast in 2004 consumer prices increased by 12.3% eop, which is four percentage points higher than the year before. In 2004 inflation was driven by three major factors: the summer increase in gasoline prices, the low supply of certain agricultural products and end-year fiscal expansion that finally spurred inflationary expectations. While fiscal imbalances are likely to be eliminated in the first half of 2005, situation at the oil-market is quite uncertain and may adversely affect inflationary developments in 2005. Additional pressure may come from liberalizing administratively regulated prices and tariffs.

Financial markets: The withdrawal of households deposits decelerated in the second half of December

Banking system. Against the background of the political events in December, household deposits further decreased by UAH 1.2 bn, or 2.9% of total households deposits. However, the rates of deposit outflows gradually reduced - compared to November - partially due to the NBU's prohibition of pre-term deposit repayments. To attract funds, the commercial banks raised interest rates on deposits by 2 to 4 percentage points on average. Thus, the situation shows signs of improvement, and is expected to stabilise in the near future.





Economic Trends		Q3 03	Q4 03	Q1 04	Q2 04	Q3 04	Aug	Sep	Oct	Nov	Dec
GDP growth (real)	% yoy	6.8	12.1	12.3	13.2	14.2	14.2	11.5	7.6	9.9	...
GDP growth (real)	% yoy cum.	8.3	9.4	12.3	12.8	13.4	13.6*	13.4*	12.7*	12.4*	...
Industrial production (real)	% yoy cum.	15.2	15.8	18.8	15.9	14.4	14.4	14.4	13.6	13.4	...
Agricultural production (real)	% yoy cum.	-16.6	-10.2	-4.0	-1.5	24.8	32.1	24.8	19.6	19.1	...
CPI	% yoy eop	6.2	8.2	6.6	8.0	10.7	9.9	10.7	11.7	11.3	12.3
PPI	% yoy eop	7.4	11.1	18.4	22.4	23.3	22.0	23.2	24.3	25.2	24.1
Exports (USD)***	% yoy cum.	23.7	24.0	38.8	42.7	39.8	47.0"	46.0"	43.3"
Imports (USD)***	% yoy cum.	25.1	28.7	32.6	29.6	26.6	29.9"	29.6"	28.0"
Merchandise trade balance	USD bn cum.	0.11	-0.27	0.77	2.23	2.91	2.96"	3.15"	3.21"
Current account	USD bn cum.	2.48	2.89	1.67	4.01	5.78	x	x	x	x	x
Current account	% GDP, cum.	7.1	5.9	14.3	15.5	13.1	x	x	x	x	x
Gross international reserves	USD bn eop	6.68	6.94	7.92	9.63	12.11	12.26	12.11	10.72	9.89	9.52
Monetary Base	% yoy eop	31.0	30.2	32.7	34.2	45.7	38.4	45.7	39.9	31.2	34.1
Lending rate on UAH credits **	% pa, eop	18.1	17.9	17.2	16.6	17.0	17.1	17.0	17.3	17.8	17.9'
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.33	5.31	5.31	5.31	5.31	5.31	5.31
Exchange rate (official)	EUR aop	6.00	6.34	6.67	6.42	6.49	6.47	6.48	6.62	6.88	7.11

SOURCES: Derzhkomstat, Ministry of Finance, NBU, IFS, own calculations

' As of December 24, 2004

" 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		1997	1998	1999	2000	2001	2002	2003	2004
Nominal GDP	UAH bn	93.4	102.6	130.4	170.1	204.2	225.8	264.2	...
Nominal GDP	USD bn	50.2	41.9	31.6	31.2	37.8	42.6	49.5	...
GDP growth (real)	% yoy	-3.0	-1.9	-0.2	5.9	9.2	5.2	9.4	...
Industrial production	% yoy	-0.3	-1.0	4.0	13.2	14.2	7.0	15.8	...
Agricultural production	% yoy	-1.9	-9.6	-6.9	9.8	10.2	1.2	-10.2	...
CPI	% yoy aop	15.9	10.6	22.7	28.2	12.0	0.8	5.2	9.0
CPI	% yoy eop	10.1	20.0	19.2	25.8	6.1	-0.6	8.2	12.3
PPI	% yoy aop	7.7	13.2	31.5	20.9	8.6	3.1	7.8	20.4
PPI	% yoy eop	5.0	35.4	15.7	20.8	0.9	5.7	11.2	24.1
Exports (gs, USD)	% yoy	0.0	-13.4	-7.9	17.9	9.5	10.7	24.0	...
Imports (gs, USD)	% yoy	2.0	-14.0	-19.1	18.9	14.1	4.9	28.7	...
Current account	USD bn	-1.3	-1.3	0.9 °	1.2 °°	1.4	3.1	2.9	...
Current account	% GDP	-2.7	-3.1	2.9 °	3.8 °°	3.7	7.6	5.9	...
FDI (net)	USD bn	0.6	0.7	0.5	0.6	0.8	0.7	1.4	...
International reserves	USD bn	2.36	0.79	1.09	1.48	3.09	4.42	6.94	9.52
Fiscal balance'''	% GDP	-6.8	-2.7	-2.1	-0.7	-1.9	0.8	-0.2	...
Total state debt	% GDP eop	30.3	49.4	61.4	45.2	36.3	34.3	29.5	...
External debt (total)	% GDP eop	19.4	38.4	49.9	33.0	26.0	24.6	17.3	...
Monetary base	% yoy eop	44.6	21.9	39.3	39.9	37.4	33.6	30.1	34.1
Exchange rate	USD aop	1.86	2.45	4.13	5.44	5.37	5.33	5.33	5.31
Exchange rate	USD eop	1.90	3.43	5.07	5.44	5.30	5.33	5.33	5.31
Exchange rate	EUR aop	2.11	2.77	4.39	5.03	4.81	5.03	6.02	6.62
Exchange rate	EUR eop	2.11	4.02	5.20	5.10	4.67	5.53	6.66	7.22

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

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