



Monthly Economic Monitor Ukraine

- Viktor Yushchenko was sworn in as President of Ukraine.
- Industrial output increased by 12.5% in 2004 thanks to growth in metallurgy, machine building and the food industry.
- The alienation of the metallurgical enterprise "Kryvorizhstal" to a third party was forbidden by a court decision.
- The State Treasury reported a central fiscal deficit of 3% of GDP for 2004.
- The minimum subsistence level and minimum pension increases may cause an additional 3% of GDP fiscal deficit in 2005.
- Fitch upgraded Ukraine's sovereign rating to BB-.

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Politics: Viktor Yushchenko became President of Ukraine

Viktor Yushchenko, the former leader of the parliamentary faction "Our Ukraine", became the President of Ukraine. The official inauguration took place on January 23. Prior to the inauguration, the team of the Yushchenko's opponent, Viktor Yanukovich, the former Prime Minister, filed a complaint with the Supreme Court of Ukraine claiming that numerous violations had occurred during the repeated second election round of December 26, which were serious enough to annul the results. However, the Supreme Court was not convinced of the evidence and sanctioned the inauguration procedure.

Immediately after being sworn into the office, Mr. Yushchenko undertook extensive foreign tours starting with Moscow. Thereafter he visited European institutions in Strasbourg and Warsaw, as well as the World Economic Forum in Davos. Many foreign leaders sent invitations to Mr. Yushchenko for an official visit, including the German chancellor and the President of the USA. After a decade of stagnating Ukrainian foreign relations and a near blockade of senior officials, Mr. Yushchenko has actively started to mend this situation.

Prior to visiting Moscow Mr. Yushchenko chose Yulia Tymoshenko, the former leader of the parliamentary faction "Bloc of Yulia Tymoshenko", to be acting Prime Minister. The Verkhovna Rada confirmed the appointment in early February. Meantime, Parliament reforms itself. The factions, which previously used to support ex-president Leonid Kuchma are losing members, and it is likely that a pro-presidential majority supporting Viktor Yushchenko will be formed from a coalition of factions.

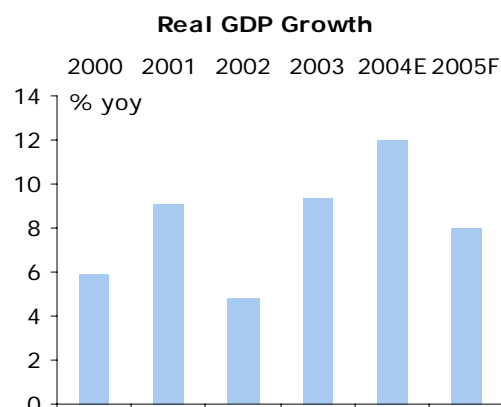
Real economy: The industrial output grew by 12.5% in 2004

According to Derzhkomstat, the real industrial output increased by 12.5% in 2004 compared to a 15.8% rise in 2003. As during the previous year, the main contributors to industrial growth were machine building, metallurgy and the food industry, together explaining more than two thirds of the overall growth. In particular, machine building production increased by 28.0% yoy, primarily due to high output growths in the electric machinery (49.3% yoy) and transport equipment (24.6% yoy) sectors. The industrial growth was stimulated by both external and domestic demand: nearly 70% of all metal products were exported, while almost 90% of the food industry and 60% of the machine building products were supplied to the domestic market. It is expected that the high growth rates of industrial production will persist, and we forecast that industrial output will increase by about 11% in 2005.

Sectoral trends: The alienation of "Kryvorizhstal" to a third party was forbidden by a court decision

Privatisation. The district court of Kyiv city rejected the alienation to a third party of 93.02% of the shares of the metallurgical

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%



Source: Derzhkomstat
E — own estimate, F — own forecast

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enterprise "Kryvorizhstal", acquired by the consortium "Investment Metallurgical Union" in June 2004. The court decision was undertaken to satisfy the suit asking to acknowledge privatisation tender invalid. The suit is explained by suspected underestimation of the "Kryvorizhstal" sale price due to distorted competition in 2004. The successful suit and the order to repeat the tender for "Kryvorizhstal" may have induced other court examinations, and may in the end result in considerable changes in the ownership structures in Ukraine.

In mid-January Parliament passed a resolution temporary restricting privatisations. Accordingly, the State Property Fund has suspended the sale and alienation of all units until the new Cabinet of Ministers will have been formed.

Agriculture. In 2004 Ukraine harvested about 41.7 m tons of grain, more than double the level of the 2003 harvest. In particular, the wheat harvest reached 17.5 m tons compared to 4.3 m tons in 2003. At the same time, Ukraine produced only about 3.4 m tons of sunflower seeds, which is almost 20% less than last year's record. As a result, prices for grain-related products dropped, while those for sunflower oil soared, contributing to inflation. According to a forecast by the consulting agency "APK-Inform", the grain harvest will be lower at the level of approximately 38-39 m tons in 2005, although wheat production is expected to remain at the 2004 level. The reasons for the expected harvest reduction are a forecast drop of crop yields and a reallocation of land towards more profitable agricultural crops such as sunflower seeds.

Infrastructure. The Verkhovna Rada amended the law on natural monopolies, introducing the participation of consumers in the process of setting tariffs. According to this amendment, all changes in tariffs for goods and services provided by natural monopolies have to be discussed with the public during open hearings. The new rule is expected to prevent enterprises from abusing their monopoly power, as well as making the tariff setting procedure more transparent.

External Sector: The merchandise trade surplus reached USD 3.4 bn

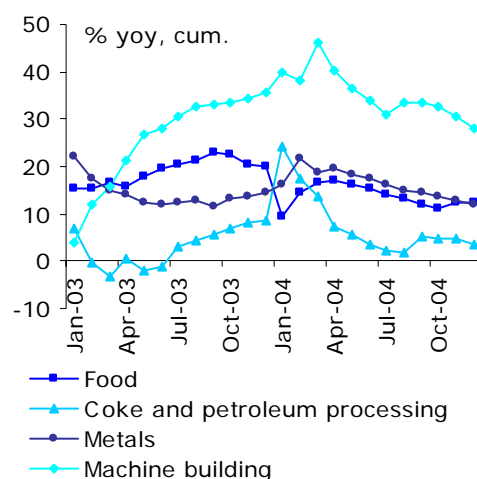
According to Derzhkomstat, the export of goods increased by 42.7% yoy in dollar terms between January and November 2004, while imports grew by 28.2% yoy. As a result, the positive merchandise balance reached USD 3.4 bn. As before, exports remained dominated by metal products, which increased by 53.6% yoy explaining almost half of the overall export growth. At the same time, exports of machine building products showed the most dynamic development. During the first eleven months of the year transport equipment exports grew by 120.5% yoy, equipment by 86.4% yoy, and electric and non-electric machinery by 30.8% yoy, indicating a gradual re-orientation of Ukrainian exports towards higher value-added products. Ukraine's imports – as in the past - were dominated by mineral products, in particular raw oil, and machinery and equipment, which together explain two third of the overall imports growth.

The Government continues using non-tariff instruments to protect the domestic market. To ensure a higher supply of selected products on domestic market, the Cabinet of Ministers extended for 2005 the export licensing of meat products, iron ores, certain non-ferrous metals, which was introduced last year. In addition, export licensing was established for iron nickel and coal tar pitch, which is conducted upon consent of the Ministry of Industrial Policy. The extension of licensing means higher transaction costs for exporters, and thus distorts market stimuli.

Fiscal policy: The deficit in 2004 reached 3% of GDP

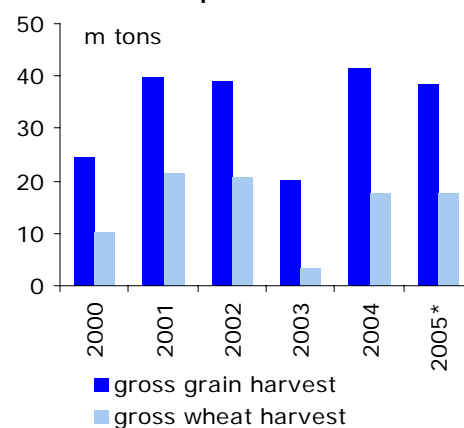
According to a preliminary Treasury report, the central government ended the year 2004 with a deficit of UAH 10.2 bn or approximately 3% of GDP. Despite the political turmoil in November-December

Growth of Output in Selected Industries



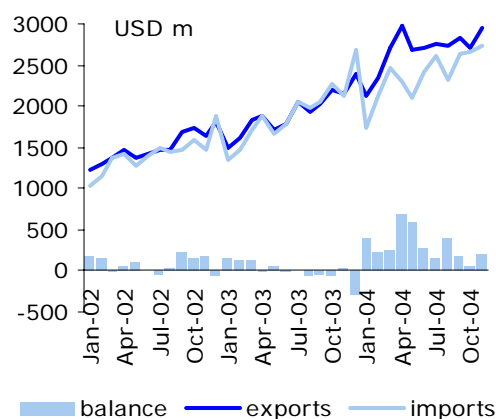
Source: Derzhkomstat

Crop Production



Source: Derzhkomstat
* "APK-Inform" Forecast

Merchandise Trade



Source: Derzhkomstat

2004, central fiscal revenues achieved 99.7% of plan, settled by the Ministry of Finance at the end of the year. The 27% over-execution of the enterprise profits tax collection allowed compensating for a significant under-execution of VAT revenues, the collection rate of which was 16% below the targeted level. The central fiscal expenditures were 3% below the Ministry of Finance plan. While the transfers to the population, important for political reasons, executed at slightly above 100%, the execution rate for capital expenditures was 7% below the projected level.

Social policy: The social payments burden on the budget increased

Parliament overruled the veto of former President Leonid Kuchma on changing the minimum subsistence level, causing the minimum subsistence level to be increased to UAH 423 from UAH 382. In addition, Leonid Kuchma approved an increase in the minimum pension to the minimum subsistence level. As estimated by the Ministry of Finance, the additional amount of funds needed to finance these new liabilities amounts to about UAH 13.5 bn for 2005. If the government finds no additional sources of revenue, the result will be an additional 3% of GDP increase in the fiscal deficit and inflationary pressure this year. Moreover, higher recurrent expenditures may limit the ability of the government to pay these levels of expenditures in the future.

Monetary policy: The monetary sector returns to the pre-crisis state

Shortly after the political uncertainty had been resolved, the monetary and banking sectors showed signs of stabilization. Several banks paid back stabilization credits before their due dates. The liquidity of the banking system increased to sufficient levels as indicated by the quickly falling interbank interest rate. The NBU, however, did not rush to ease its monetary policy and kept its refinancing rates rather high. Accordingly, the growth rates of the money supply and the monetary base slowed to 35.7% yoy and 34.5% yoy respectively.

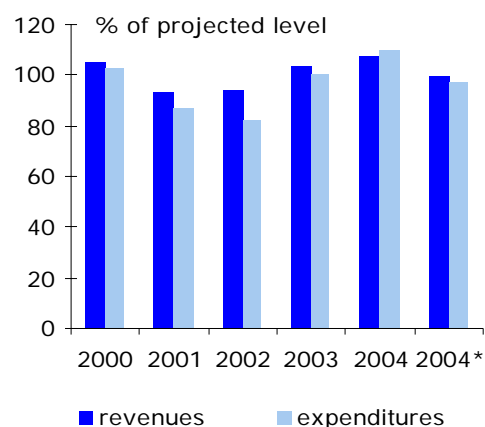
In January consumer prices rose by 12.6% yoy mainly driven by the development of food-products prices, which grew by 16.3% yoy. It is expected that the inflation will slow to more moderate levels during the second half of the year to a level of about 9.2% eop.

Financial markets: Fitch upgraded Ukraine to BB-

Government debt market. Soon after Viktor Yushenko won the presidential elections, the international agency Fitch Ratings, upgraded Ukraine's sovereign credit rating from B+ to BB-, which brings it to a level equal to that of Brazil and Turkey, still leaving the country three notches below investment grade. At the same time, Fitch kept its outlook for Ukraine's long-term foreign and local currency ratings at stable. The upgrade was largely the result of Ukraine resolving its political crisis, its moderate public and external debt ratios, the high current account surplus, and strong growth prospects. However, a number of on-going economic and financial risks remain, associated with the uncertainty over the budget position and the vulnerability of the banking sector. Overall, Ukraine's upgraded sovereign rating confirms its growing investment attractiveness and may open access to international capital markets for Ukrainian banks and companies at more favourable conditions.

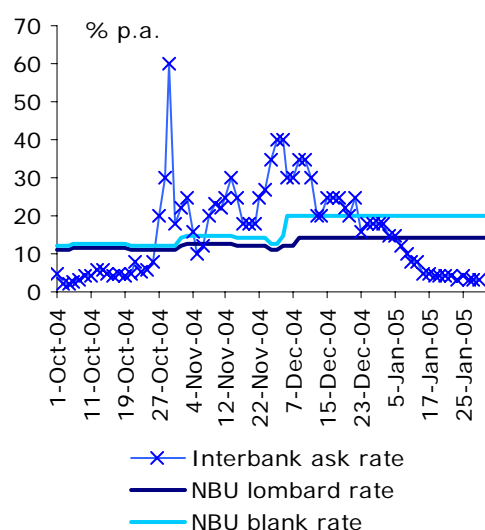
Foreign exchange market. As a consequence of the political stabilisation, the demand for cash foreign currency decreased in January compared to previous months. The cash exchange rate is approaching the pre-crisis level. At the interbank foreign exchange market the supply of foreign currency outweighed demand, helping the NBU to replenish its international reserves by USD 0.5 bn in January, to now total USD 10.1 bn.

Execution Rate of Central Fiscal Revenues and Expenditures



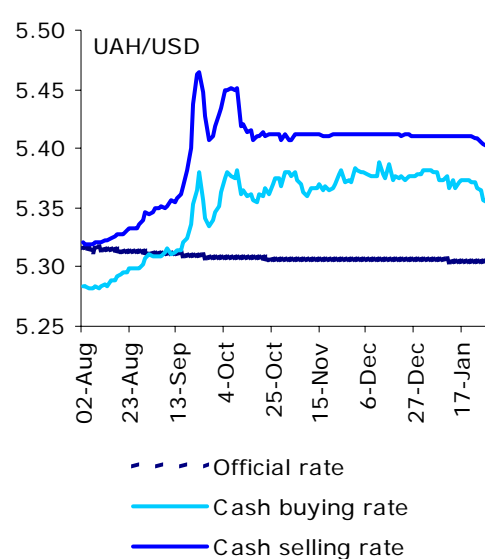
Source: State Treasury, Ministry of Finance
Note: * - plan amended by M in Fin

Interbank and NBU Overnight Rates



Source: NBU, Ukrainian financial server

UAH/USD Exchange Rate



Sources: NBU, Ukrainian financial server



Economic Trends		Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Oct	Nov	Dec	Jan
GDP growth (real)	% yoy	12.1	12.3	13.2	14.2	...	7.6	9.9
GDP growth (real)	% yoy cum.	9.4	12.3	12.8	13.4	...	12.7*	12.4*	12.0*	...
Industrial production (real)	% yoy cum.	15.8	18.8	15.9	14.4	...	13.6	13.4	12.5	...
Agricultural production (real)	% yoy cum.	-10.2	-4.0	-1.5	24.8	...	19.6	19.1	19.1	...
CPI	% yoy eop	8.2	6.6	8.0	10.7	12.3	11.7	11.3	12.3	12.6
PPI	% yoy eop	11.1	18.4	22.4	23.3	24.1	24.3	25.2	24.1	22.6
Exports (USD)***	% yoy cum.	24.0	38.8	42.7	39.8	...	43.3"	42.7"
Imports (USD)***	% yoy cum.	28.7	32.6	29.6	26.6	...	28.0"	28.2"
Merchandise trade balance	USD bn cum.	-0.27	0.77	2.23	2.91	...	3.21"	3.41"
Current account	USD bn cum.	2.89	1.67	4.01	5.78	...	x	x	x	x
Current account	% GDP, cum.	5.9	14.3	15.5	13.1	...	x	x	x	x
Gross international reserves	USD bn eop	6.94	7.92	9.63	12.11	9.52	10.72	9.89	9.52	10.10
Monetary Base	% yoy eop	30.2	32.7	34.2	45.7	34.1	39.9	31.2	34.1	34.5
Lending rate on UAH credits **	% pa, aop	17.9	17.2	16.6	17.0	17.9'	17.3	17.8	17.9'	18.1
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.31	5.31	5.31	5.31	5.31	5.30
Exchange rate (official)	EUR aop	6.34	6.67	6.42	6.49	6.88	6.62	6.88	7.11	6.98

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	12.0 ^e
Industrial production	% yoy	-0.3	-1.0	4.0	13.2	14.2	7.0	15.8	12.5
Agricultural production	% yoy	-1.9	-9.6	-6.9	9.8	10.2	1.2	-11.0	19.1
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 ^o	1.2 ^{oo}	1.4	3.1	2.9	...
Current account	% GDP	-2.7	-3.1	2.9 ^o	3.8 ^{oo}	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

^o 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

^{oo} 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.

^e Preliminary estimate of the Derzhkomstat

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