



MONTHLY ECONOMIC MONITOR UKRAINE

- Yulia Tymoshenko became Prime Minister of Ukraine, supported by an overwhelming majority in Parliament.
- Viktor Yushchenko voiced Ukraine's interest in becoming a NATO member and later on an EU member.
- The real GDP grew by 6.5% yoy in January 2005, decelerating compared to the previous year's figure.
- The merchandise trade surplus reached USD 3.7 bn in 2004, with the enlarged EU now being the major trade partner of Ukraine.
- The review of the privatisation has created uncertainty over property rights in Ukraine.
- During January and February the NBU increased its official reserves to USD 10.9 bn.

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Politics: Yulia Tymoshenko became Prime Minister

On February 4 the Verkhovna Rada approved the candidature of Yulia Tymoshenko for the position of Prime Minister of Ukraine by 373 votes. A new Cabinet of Ministers was chosen immediately thereafter with most of the positions going to deputies from the former opposition factions. New oblast governors were appointed at the same time. The new prime minister presented the "Program of the Cabinet of Ministers" to Parliament, which was approved by 357 votes thus giving the Government a 1-year term until the next parliamentary review. One of the first steps of the newly appointed government was to subordinate 14 state committees to the ministries, thus starting the administrative reform.

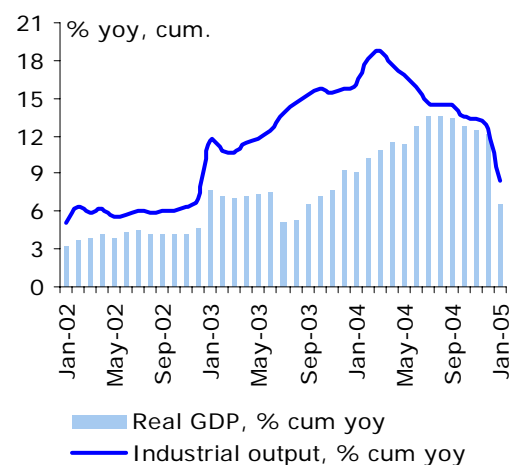
February was marked by intense foreign policy undertakings by the new President and his team. Mr. Yushenko was the only president of a non-NATO country present at the recent NATO meeting in Brussels. He took part in the work of the Ukraine-NATO commission, in which the president of the USA, George Bush, also participated. The President of Ukraine indicated his readiness to improve cooperation with NATO, and to see Ukraine accepted as a member in the future. During the 8th EU-Ukraine Cooperation Council meeting, also held in Brussels, the EU formally acknowledged Ukraine's European ambitions and made it clear that the new commitment to democracy and reforms opened new prospects for EU-Ukraine relations. The Vice Prime Minister of Ukraine for European Integration, Oleg Rybachuk, signed the Ukraine-EU Action Plan, which defines the cooperation between Ukraine and the European Union until 2007. Furthermore, Viktor Yushenko declared Ukraine's willingness to start negotiations for EU membership in 2007 assuming successful implementation of the Action Plan.

Real economy: The growth of the real GDP decelerated at the beginning of 2005

According to Derzhkomstat, the real GDP grew by 6.5% yoy in January 2005, compared to 9.0% yoy in January 2004. A slowdown of growth rates in industry and trade, as well as negative growth rates in construction contributed to the lower real GDP figure. In construction the value added reduced by 1.0% yoy in real terms to a great extent due to completion of large projects like the construction of nuclear reactors. Industrial output increased by 8.4% yoy, growing at nearly half the rate of last year. The major reason was a dramatic deceleration in machine building growth, the output of which increased by only 0.8% yoy against a background of the high statistical base of last year (59.5% yoy rise in January 2004). If low figures in construction and machine building persist during the coming months, this would point to a significant slowdown in investment activity in the country.

Population: 47.3 m
Industry/GDP: 28.7%
Agriculture/GDP: 10.8%
Investment/GDP: 20.1%
Export to: Russia 17%, EU 33%
Import from: Russia 35%, EU 32%

GDP and Industrial Output



Source: Derzhkomstat

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Sectoral trends: Increased uncertainty on property rights

Privatisation. The review of the privatisation has created uncertainty over property rights in the country. Viktor Yuschenko claimed that nearly 30 enterprises could be subject to a review of their privatisation and that a final list of companies subject to re-privatisation will soon be completed. At present the fairness of the privatisation of several big industrial enterprises, including the metallurgical plant "Kryvorizhstal", is being disputed in the courts. Moreover, the government has annulled previous Cabinet of Ministers decisions concerning the privatisation procedure for this enterprise. The competence and the transparency of the court decisions that will be rendered on every case of potential re-privatisation will seriously influence investors' expectations. It will allow inferring whether Ukrainian privatisation returns to the realm of transparency and competitiveness, and whether the investment climate in Ukraine is becoming more favourable.

External Sector: The merchandise trade balance reached USD 3.7 bn in 2004

According to Derzhkomstat, the export of goods increased by 41.6% in dollar terms in 2004, while imports grew by 26.0%. As a result, the merchandise trade balance reached USD 3.68 bn compared to USD 0.06 bn in 2003. Due to high world prices, ferrous metals contributed 42% of the overall exports growth. At the same time, Ukraine has accelerated its exports of machinery and transport equipment, which explains another 18% of the exports increase. Imports of mineral products, machinery, and transport equipment explain more than 70% of the overall imports growth.

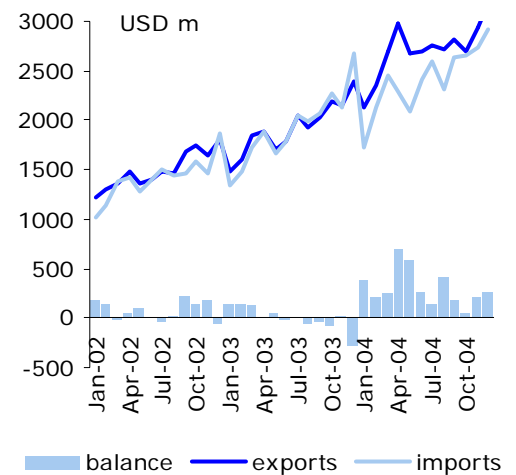
After May 2004, the enlarged EU became the major trading partner of Ukraine. The merchandise trade with the EU-25 in 2004 constituted 31% of Ukraine's overall trade turnover, while trade turnover with Russia, which remains the largest single trade partner country, was 29%. Last year exports to the EU-25 increased by 24%, although the change in the trade regime caused a reduction of exports to Estonia, Hungary, and Slovenia. Imports from the EU-25, a key source of investment products, grew by 21%. The development of foreign trade with other regions of the world was more dynamic. Both exports to and imports from Russia grew by 37%, replicating the previous year's growth rates. Also, Ukraine intensified its exports to Asia, which increased by 49% compared to a 7% rise in 2003. Imports from Asia decelerated to 12%.

Fiscal policy: The Government has approved a 20% VAT rate for imported oil

In February the Government approved a 20% VAT rate for imported oil to be effective as of March 2005. This decision replaces the 0% VAT rate for imported crude oil from Russia, which was established in order to avoid double taxation. Until December 2004 VAT was already charged by Russia, the country of origin. According to official estimates, this will allow the Government to receive additional fiscal revenues of UAH 6 bn. Additional funds will likely be received due to the elimination of tax evasion schemes.

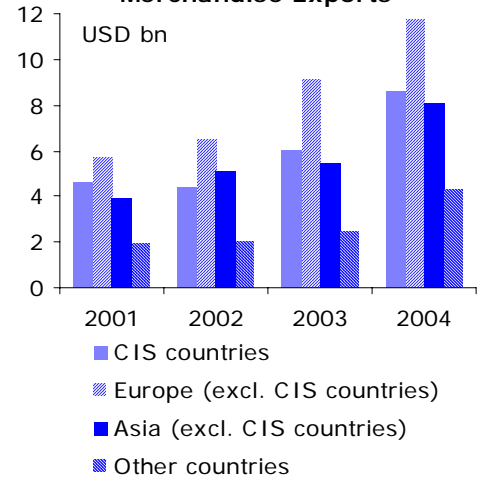
In January 2005 the central fiscal revenues were executed at 91%. Such major sources of revenues as the VAT and non-tax revenues appear to be 14% and 25% below target respectively. This was partially compensated by over-execution of the enterprise profits tax and excises at 12% and 13% respectively. As usual at the beginning of the year, fiscal expenditures were significantly below the target. In particular, the central fiscal expenditures execution rate was 75%. The resulting central fiscal surplus was UAH 0.5 bn.

Merchandise Trade



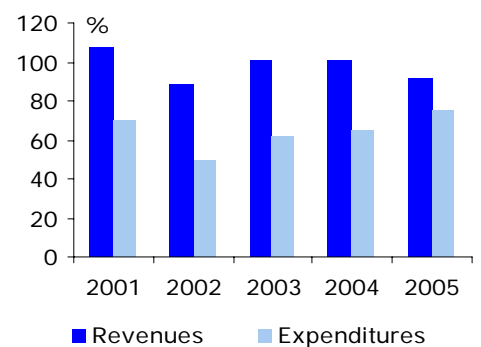
Source: Derzhkomstat

Regional Distribution of Merchandise Exports



Source: Derzhkomstat

Central Fiscal Execution in January



Source: Treasury reports

Social policy: The share of transfers in household incomes reached 40% in December 2004

The real income of households increased by 14.4% in 2004. The major reason was the higher social assistance payments, caused by the introduction of state aid to pensioners starting in September 2004. From September to December 2004 the income received from social assistance increased by 52.6% yoy, while earned wages rose by 11.9% yoy. As a result, in December the share of income received in the form of transfers to the population grew from 35% to nearly 40%, almost equalling the share of wages. Should this trend continue more funds would be required to finance the social transfers, which could imply higher taxes for the labour force in the future.

According to Derzhkomstat, the structure of household expenditures remained almost unchanged, dominated by purchases of food products. However, in 2004 households accumulated less money in deposit accounts in banks, bought fewer shares, and returned to savings in foreign currency, breaking the trend of the year 2003. This household behaviour can be explained by the political instability during the last quarter of 2004.

Monetary policy: The NBU renewed purchases of foreign currency replenishing its official reserves

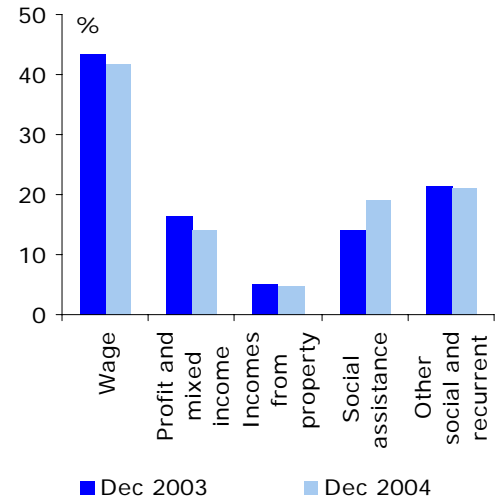
At the beginning of 2005 the NBU renewed purchases of foreign currency at the interbank market. From January to February the NBU foreign exchange reserves were replenished by USD 1.4 bn, reaching USD 10.9 bn. By buying foreign currency, the central bank supplied hryvnia to the domestic banking system, increasing the monetary base, which had grown by 36.4% yoy by the end of February. Accordingly, the liquidity of the banking system increased pushing banks to expand credits. This contributed to a reduction of the banks' credit rates. In February the average interest rate on hryvnia credits reduced to 16.8% p.a from 18.1% p.a. in January. It is unlikely, however, that interest rate reductions will continue at the current pace, since fears of high inflation will prevent banks from reducing much of their deposits and consequently credits rates. In February CPI inflation reached 13.3% yoy.

Financial markets: Moody's improved the outlook on Ukraine to 'stable'

Government debt market. Moody's Investors Service changed the outlook on Ukraine from 'developing' to 'stable'. The revision was undertaken due to the renewed political stability following the presidential elections and the recent appointment of a new government. Moody's placed a stable outlook on Ukraine's "B1" foreign-currency ceiling, as well as on foreign and domestic currency government bonds. It also confirmed the foreign-currency bank deposit ceiling at "B2" with a stable outlook, which had been under review for downgrade since early December. The revision of Moody's outlook is a positive signal to foreign investors and is likely to strengthen Ukraine's position at international capital markets.

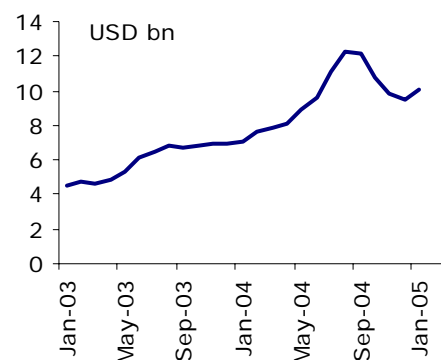
Foreign exchange market. In late February the NBU cancelled an administrative 2% restriction on deviations of the sale and purchase prices for cash foreign currency from the official rate. The regulator's decision to loosen its control over the cash currency rate was underpinned by a considerable reduction in household demand for cash foreign exchange at the beginning of 2005 and a revival of a relatively stable situation at the foreign exchange market. Particularly, in January net purchases of foreign cash by households were USD 0.2 bn compared to USD 0.8 bn in December 2004. In February the demand for foreign cash further decreased, the net purchase coming to USD minus 0.03 bn. In the near future, the banks' cash rates are likely to fall below the 2% limit and may, thereby, speed up the natural renewal of stability at the market.

Households' Income



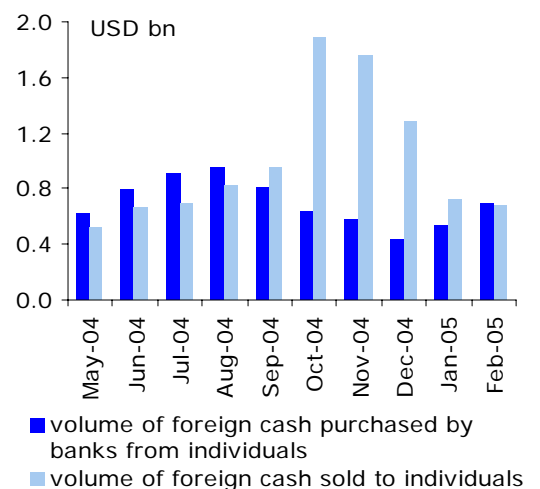
Source: Derzhkomstat

NBU Gross International Reserves



Source: NBU

Volume of Transactions at Foreign Cash Market



Source: NBU



| Economic Trends | | Q4 03 | Q1 04 | Q2 04 | Q3 04 | Q4 04 | Oct | Nov | Dec | Jan | Feb |
|--------------------------------|-------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| GDP growth (real) | % yoy | 12.1 | 12.3 | 13.2 | 14.2 | ... | 7.6 | 9.9 | ... | 6.5 | ... |
| GDP growth (real) | % yoy cum. | 9.4 | 12.3 | 12.8 | 13.4 | 12.1 | 12.7* | 12.4* | 12.0* | 6.5* | ... |
| Industrial production (real) | % yoy cum. | 15.8 | 18.8 | 15.9 | 14.4 | 12.5 | 13.6 | 13.4 | 12.5 | 8.4 | ... |
| Agricultural production (real) | % yoy cum. | -10.2 | -4.0 | -1.5 | 24.8 | 19.4 | 19.6 | 19.1 | 19.1 | 3.7 | ... |
| CPI | % yoy eop | 8.2 | 6.6 | 8.0 | 10.7 | 12.3 | 11.7 | 11.3 | 12.3 | 12.6 | 13.3 |
| PPI | % yoy eop | 11.1 | 18.4 | 22.4 | 23.3 | 24.1 | 24.3 | 25.2 | 24.1 | 22.6 | 22.3 |
| Exports (USD)*** | % yoy cum. | 24.0 | 38.8 | 42.7 | 39.8 | ... | 43.3" | 42.7" | 41.6" | ... | ... |
| Imports (USD)*** | % yoy cum. | 28.7 | 32.6 | 29.6 | 26.6 | ... | 28.0" | 28.2" | 26.0" | ... | ... |
| Merchandise trade balance | USD bn cum. | -0.27 | 0.77 | 2.23 | 2.91 | ... | 3.21" | 3.41" | 3.68" | ... | ... |
| Current account | USD bn cum. | 2.89 | 1.67 | 4.01 | 5.78 | ... | x | x | x | x | x |
| Current account | % GDP, cum. | 5.9 | 14.3 | 15.5 | 13.1 | ... | x | 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 | 10.94 |
| Monetary Base | % yoy eop | 30.2 | 32.7 | 34.2 | 45.7 | 34.1 | 39.9 | 31.2 | 34.1 | 34.5 | 36.4 |
| 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 | 16.8 |
| Exchange rate (official) | USD aop | 5.33 | 5.33 | 5.33 | 5.31 | 5.31 | 5.31 | 5.31 | 5.31 | 5.30 | 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 | 6.89 |

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 | 345.9 ^e |
| Nominal GDP | USD bn | 50.2 | 41.9 | 31.6 | 31.2 | 37.8 | 42.6 | 49.5 | 65.1 ^e |
| GDP growth (real) | % yoy | -3.0 | -1.9 | -0.2 | 5.9 | 9.2 | 5.2 | 9.4 | 12.1 ^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 | -3.4 |
| Total state debt | % GDP eop | 30.3 | 49.4 | 61.4 | 45.2 | 36.3 | 34.3 | 29.5 | 24.7 |
| External debt (total) | % GDP eop | 19.4 | 38.4 | 49.9 | 33.0 | 26.0 | 24.6 | 17.3 | 18.6 |
| 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 |