



# MONTHLY ECONOMIC MONITOR UKRAINE

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- The Putin-Yushchenko commission was established during a visit to Ukraine by the President of the Russian Federation, Vladimir Putin.
- Real GDP growth slowed to 5.5% yoy during the first two months, compared to 10.2% yoy during the same period last year.
- The import tariffs for selected exotic fruit, linen, underwear, footwear, and home equipment were significantly reduced.
- In 2004, the current account surplus reached the historical maximum of USD 6.8 bn, or 10.4% of GDP.
- The planned revenues and expenditures of Budget-2005 were increased to UAH 106 bn and UAH 114 bn respectively.
- In March inflation rose to 14.7% yoy.
- The 50% mandatory sale of foreign currency receipts was abolished.

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%

## Politics: Commission Putin-Yushchenko was established

The President of Russia, Vladimir Putin, visited Ukraine in March. During meetings with the President of Ukraine, the Prime Minister and the Head of the Verkhovna Rada a number of issues were discussed including cooperation in the energy sphere, the common economic space, and military cooperation. The two presidents agreed to establish the Putin-Yushchenko commission, which will be working at the level of the national security councils of the two countries, to develop solutions for common problems.

In March Viktor Yushchenko announced that suspects in the killing of Georgiy Gongadze, the journalist murdered during the rule of Leonid Kuchma, had been arrested. The main question remaining is to find those who ordered the killing. The ex-minister of Internal Affairs, Yuri Kravchenko, invited to the Office of the Prosecutor General to testify in the Gongadze case, was found dead in his house. The official claim is that his death was a suicide. The former president, Leonid Kuchma, and the Head of Parliament, Volodymyr Lytvyn, have also testified in the Gongadze case. Viktor Yushchenko admitted that Ukraine sold 12 X-55 missiles to Iran and China in 2001. The range of these missiles reaches 3,000 kilometres, which makes Japan and the USA to worry about the leakage of technologies strengthening the technological capacities of these countries in the nuclear sphere.

## Real economy: The GDP growth continues to slow

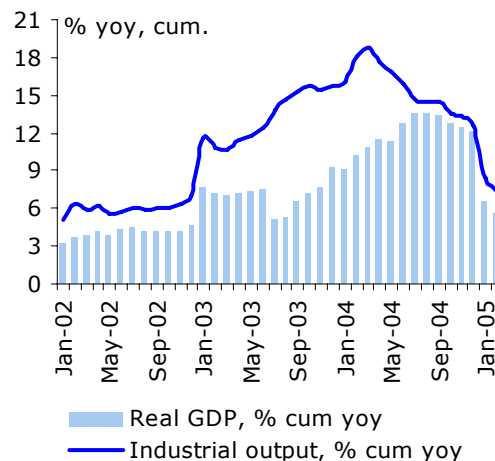
The country's economic growth continued to slow at the beginning of 2005 compared to last year's figures. According to Derzhkomstat, the real GDP increased by 5.5% yoy during the first two months of the year, i.e. at nearly half the rate of last year. In addition to lower growth rates in manufacturing and transport, there was a significant deceleration of value added growth in the wholesale and retail trades that increased by a mere 1.8% yoy, principally due to reduced wholesale trade. Moreover, the growth rate of value added in construction remained negative for the second month in a row.

The industrial output grew by 7.3% yoy between January and February, also demonstrating much more modest growth rates than during the same period of the previous year. The deceleration of the extractive and manufacturing productions was only slightly counterweighted by increased production and distribution of electricity, gas and water. The only industry developing faster than last year is the food industry that grew by 17.4% yoy, stimulated by a continuous rise in domestic households demand.

## Sectoral trends: The privatisation receipts for 2005 are planned at UAH 6.98 bn

**Privatisation.** According to the amendments to Budget-2005, the

GDP and Industrial Output



Source: Derzhkomstat

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and Policy Consulting  
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privatisation revenues for 2005 are expected to reach UAH 6.98 bn. Attaining this figure will be possible if several big stakes like "Ukrtelecom" and the Odessa Portside Factory are sold.

The legitimacy of last year's privatisation of several enterprises continues to be disputed in the courts. A suit concerning the biggest enterprise in question, the metallurgical enterprise "Kryvorizhstal", is being considered by the Commercial Court. A case considering the legitimacy of founding the large chemical enterprise "Azot", of which 60% of the shares were acquired by Worldwide Chemicals LLC (USA) last year, has been resolved by the Pechersk district court in Kiev City, which recognized the foundation as illegitimate.

### External Sector: Ukraine reduces selected import tariffs

The Parliament adopted import tariff changes, introducing significant tariff reductions for selected exotic fruits, linen, underwear, footwear, and home equipment. It is expected that this measure will stimulate legal imports of these products and reduce smuggling. The tariff reduction is not likely to significantly affect the merchandise trade balance since these products constitute a very small share of total imports, which are dominated by mineral products, machinery and chemicals.

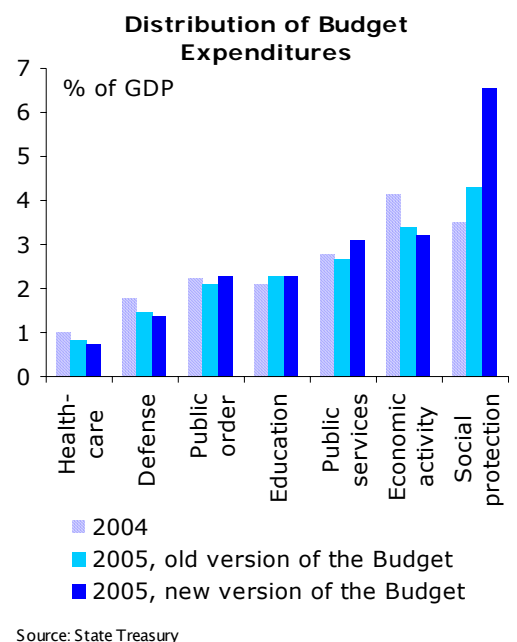
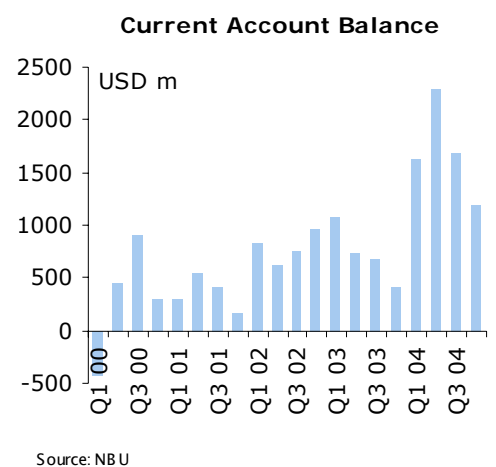
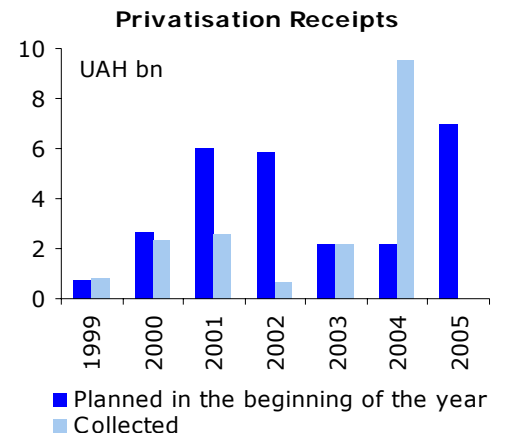
According to the NBU, the current account surplus in 2004 reached a historical maximum: USD 6.8 bn. The balance of trade in goods totalled USD 3.7 bn, thanks to export growth outstripping imports. Thus, commodity exports increased by 40.8% yoy in dollar terms, while imports grew by 23.7% yoy. Current transfers at USD 2.6 bn were the second most important component of the high current account balance. The FDI inflow in 2004 increased by 20.4% yoy to USD 1.7 bn. Although the per capita FDI stock reached approximately USD 180, it still remains one of the lowest among the countries of Central and Eastern Europe.

According to Derzhkomstat, the commodity trade grew much slower in January 2005. Exports of goods increased by only 16.0% yoy in dollar terms compared to almost 43.0% yoy in January 2004, mainly due to reduced exports to Europe. At the same time, imports grew by only 4.0% yoy after a 29.0% rise at the beginning of last year, primarily because of decreased imports of raw mineral products from CIS countries.

### Fiscal policy: Budget-2005 was significantly expanded

Recent amendments to the State Budget 2005, signed by the President, changed the central fiscal revenues to UAH 106 bn and expenditures to UAH 114 bn, resulting in a UAH 7 bn deficit (1.6 % of GDP). The expenditures were increased by UAH 19 bn, which will be directed primarily to social transfers. The transfers to the Pension Fund and to the local budgets accounted for 55% and 16% of the overall increase respectively. The rise in expenditures was matched by a growth in revenues of UAH 20 bn due to revised macroeconomic parameters (36%), eliminated privileges and increased excise taxes (42%), and higher state monopoly revenues (20%). However, it is questionable whether the additionally budgeted revenues will be received in full, since the adopted measures may slow the economic activity in the country. Moreover, the increased expenditures are intended for consumption purposes, while the investment component of the budget was reduced, which creates macroeconomic risks associated with high inflation and slowing economic growth.

In January and February 2005, 100% of the budgeted fiscal revenues were collected, due to good performance of EPT, import duty, and excises on domestically produced goods. At the same time, the collection of VAT revenues still remains problematic. Only 84% of the planned VAT revenues were received, and the budget refund of VAT was 36% below target. The expenditures execution improved and reached 86%, compared to 75% in January. The central fiscal surplus stayed at about 2% of GDP.



**Social policy: Social expenditures go up**

The amendments to the State Budget 2005 envisage a sharp increase in social expenditures, primarily, pensions, minimum wages and different social welfare payments. Planned social expenditures allow fulfilling the recently adopted legislative provision, according to which the minimum pension shall rise to UAH 332 per month - the subsistence minimum for people who lost their ability to work. It is also planned to differentiate pensions according to the working record, thus, re-instituting incentives for people to participate in the state compulsory pension insurance. The minimum wage will be gradually increased to the same UAH 332 per month by September 2005, and a unified tariff scale will be introduced in the budget. The increases in social payments will improve the people's living standards in the short-run, but will create inflationary pressure that may nullify these benefits.

**Monetary policy: The growth rate of consumer prices accelerates**

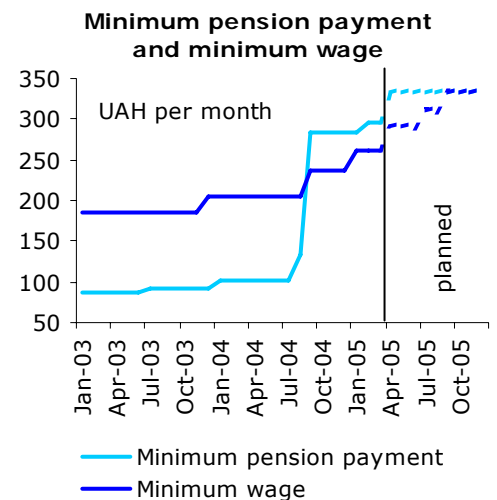
In March consumer prices grew by 14.7% yoy surpassing the dynamics of previous months. A large part of the inflation seems to be explained by inflationary expectations of producers, who increase their products prices now, because they anticipate the inflationary process to speed up in the near future. Additional inflationary pressure is likely to come from the demand side as substantial amounts of the state budget are now directed to low-income groups of the population. Taking these trends into account, it is forecast that prices will grow by 14-15% yoy by the end of the year.

The March growth rates of the monetary base and the money supply were 45.5% and 38.6% yoy respectively. The growth of the monetary aggregates was caused by the renewed inflow of deposits and NBU purchases of foreign currency at the foreign exchange market aimed at preventing a rapid appreciation of the hryvnia. The foreign exchange surplus is generated by a positive trade balance and, to a lesser extent, by an inflow of foreign capital caused by increased interest of international investors in domestic government bonds. It is likely that the recent rescinding of the requirement for exporters to sell 50% of their foreign exchange receipts will lead to some monetary tightening in the coming months. In addition, the money supply growth will slow even more, should the NBU opt for a speeded-up appreciation of the hryvnia.

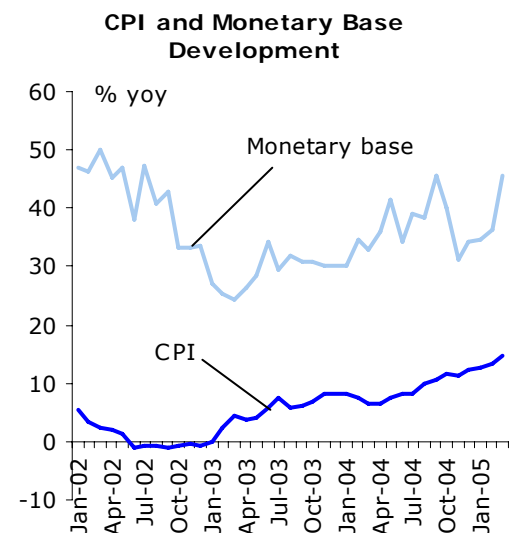
**Financial markets: The mandatory sale of foreign currency receipts was abolished**

**Foreign exchange market.** By a joint decision, the Cabinet of Ministers and the NBU abolished the mandatory sale by exporters of 50% of their foreign currency receipts at the interbank market. The regulation had been adopted in 1998 as an anti-crisis measure that helped the NBU to alleviate the devaluation pressure on the hryvnia at that time. According to the official explanation, abolishing this obligatory sale will help to curb inflation. However, lower foreign exchange surplus that might be caused by the decision, and accompanying it monetary tightening are not likely to affect the growth of prices, since very little of the money issued by the NBU when purchasing foreign currency goes to the consumer market.

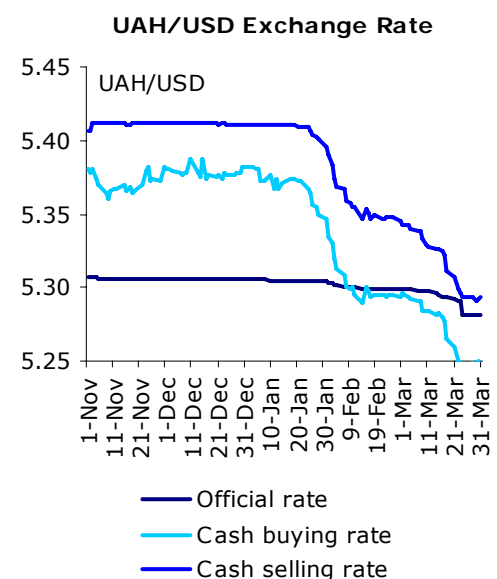
**Government debt market.** The cost of the domestic government borrowings has been going down since the beginning of 2005. In March the yield to maturity for new issues has fallen to 6.74% p.a. compared to 9.82% p.a. in February and around 11% p.a. in 2004. The reduction can be attributed to a drastic increase in demand for government bonds by international investors. According to the Ministry of Finance, international investors bought 60% of the latest bond issues. In total, their portfolios of Ukrainian government bonds constitute about UAH 2.5 bn, or 37% of all domestic government debt outstanding. It is expected that the interest in these securities will remain high, contributing to low yields to maturity.



Source: Legislation of Ukraine



Source: Derzhkomsstat, NB U



Sources: NB U, Ukrainian financial server



Economic Trends		Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Dec	Jan	Feb	Mar
GDP growth (real)	% yoy	12.1	12.3	13.2	14.2	...	...	6.5	4.5	...
GDP growth (real)	% yoy cum.	9.4	12.3	12.8	13.4	12.1	12.0*	6.5*	5.5	...
Industrial production (real)	% yoy cum.	15.8	18.8	15.9	14.4	12.5	12.5	8.4	7.3	...
Agricultural production (real)	% yoy cum.	-10.2	-4.0	-1.5	24.8	19.4	19.1	3.7	3.5	...
CPI	% yoy eop	8.2	6.6	8.0	10.7	12.3	12.3	12.6	13.3	14.7
PPI	% yoy eop	11.1	18.4	22.4	23.3	24.1	24.1	22.6	22.3	22.0
Exports (USD)***	% yoy cum.	24.0	39.8	44.0	41.0	37.2	41.6"	16.0"	...	...
Imports (USD)***	% yoy cum.	28.7	34.6	31.9	28.8	26.0	26.0"	4.0"	...	...
Merchandise trade balance	USD bn cum.	-0.27	0.93	2.49	3.26	3.74	3.68"	0.68"	...	...
Current account	USD bn cum.	2.89	1.63	3.93	5.62	6.80	x	x	x	x
Current account	% GDP, cum.	5.9	13.6	14.7	12.2	10.4	x	x	x	x
Gross international reserves	USD bn eop	6.94	7.92	9.63	12.11	9.52	9.52	10.10	10.94	11.95
Monetary Base	% yoy eop	30.2	32.7	34.2	45.7	34.1	34.1	34.5	36.4	45.5
Lending rate on UAH credits **	% pa, aop	17.9	17.2	16.6	17.0	17.9'	17.9'	18.1	16.8	17.0
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.31	5.31	5.31	5.30	5.30	5.29
Exchange rate (official)	EUR aop	6.34	6.67	6.42	6.49	6.88	7.11	6.98	6.89	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	345.9 <sup>e</sup>
Nominal GDP	USD bn	50.2	41.9	31.6	31.2	37.8	42.6	49.5	65.1 <sup>e</sup>
GDP growth (real)	% yoy	-3.0	-1.9	-0.2	5.9	9.2	5.2	9.4	12.1 <sup>e</sup>
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	37.2
Imports (gs, USD)	% yoy	2.0	-14.0	-19.1	18.9	14.1	4.9	28.7	26.0
Current account	USD bn	-1.3	-1.3	0.9 <sup>o</sup>	1.2 <sup>oo</sup>	1.4	3.1	2.9	6.8
Current account	% GDP	-2.7	-3.1	2.9 <sup>o</sup>	3.8 <sup>oo</sup>	3.7	7.6	5.9	10.4
FDI (net)	USD bn	0.6	0.7	0.5	0.6	0.8	0.7	1.4	1.7
International reserves	USD bn	2.36	0.79	1.09	1.48	3.09	4.42	6.94	9.52
Fiscal balance <sup>'''</sup>	% 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

<sup>o</sup> 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

<sup>oo</sup> 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.

<sup>e</sup> Preliminary estimate of the Derzhkomstat

#### Notes:

<b>avg</b>	average	<b>ytd</b>	year-to-date
<b>cum.</b>	cumulative	<b>p.a.</b>	per annum
<b>mom</b>	month on month change	<b>eop</b>	end of the period
<b>qoq</b>	quarter on quarter change	<b>aop</b>	average of the period
<b>yoy</b>	year on year change	<b>gs</b>	goods and services