



MONTHLY ECONOMIC MONITOR UKRAINE

- During his visit to the USA Viktor Yushchenko, the President of Ukraine, met with the President George W. Bush and addressed a joint session of the Congress.
- The real GDP growth reached 5.4% yoy during the first quarter.
- To fight price increases, the Government set maximum prices for gasoline and temporarily banned the exports of oil products.
- The Government made an attempt to reduce meat prices by lowering import tariffs and by directly intervening in the market.
- The Cabinet of Ministers temporarily increased all railway freight transportation tariffs until the end of June 2005.
- Starting April 1, 2005 birth grants were increased to UAH 8497.
- The NBU revalued the hryvnia to 5.05 UAH/USD.
- The consumer price inflation stayed at a high 14.7% yoy.

**No.5 (55)
May
2005**

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: Viktor Yushchenko visited the USA

In April Viktor Yushchenko, the President of Ukraine, visited Washington, which was the first visit of a Ukrainian Head of state to the USA after several years of strained relations. Mr. Yushchenko met with President George W. Bush, and made a speech at a joint session of Congress. The topics discussed during the visit included, among others, US support for Ukraine's WTO accession, provision of market economy status, repeal of the Jackson-Venick amendment, and withdrawal of Ukrainian troops from Iraq. During the same month Mr. Yushchenko made a statement at a NATO-Ukraine commission meeting identifying integration into the structure of NATO as a long-term goal of Ukraine.

Anatoliy Matvienko, the Head of the Ukrainian Republic Party "Sobor" and a member of the parliamentary party "Yulia Tymoshenko Bloc", became the new Prime Minister of the Autonomous Republic of Crimea, appointed by the Crimean Parliament. Also, Valentyna Semenyuk, a former peoples deputy and a member of the Socialist Party, was appointed as Head of the State Property Fund. These appointments reflect the wave of changes in personnel policy, started after the elections. So far some 18,000 new appointments were made as the newly elected Government reshapes the bureaucracy.

Real economy: The real GDP increased by 5.4% yoy

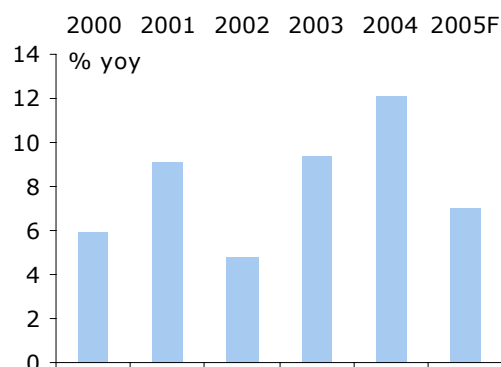
According to Derzhkomstat, the real GDP grew by 5.4% yoy in the first quarter of 2005 compared to a 12.7% yoy rise during the same period of last year. Slowing growth was registered in all major sectors of the economy, except in agriculture. The latter has grown by 5.1% yoy against a background of negative growth rates of value added at the beginning of 2004. A high statistical base and an uncertain investment situation contributed to a continuous reduction of value added in construction that dropped by 5.9% yoy during the first three months of the year. It is expected that investment activity will significantly decelerate in 2005, not reaching even half of last year's 28.0% growth of fixed capital investment.

Industrial output increased by 7.1% yoy in the first three months, thanks to growth in the food industry and in machine building. Growth rates of the latter have accelerated in March, reaching 11.3% yoy. At the same time metallurgy, one of the key sectors of manufacturing, grew by only a very moderate 1.6% yoy in comparison with 19.6% yoy in the first quarter of 2004.

Sectoral trends: The Government intervened on the gasoline and meat markets to slow price increases

Energy. In April Ukraine faced a rise of about 15% in petroleum product prices, due to higher world prices for oil and seasonal

Real GDP Growth



Source: Derzhkomstat
F — own forecast

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increases in the demand for refinery products. The Government reacted with administrative measures, setting maximum prices both at the wholesale and retail gasoline markets and temporary banning exports of oil products. The oil refineries vehemently opposed these actions of the Government, however, after several rounds of negotiations the parties managed to reach an agreement. The revaluation of the hryvnia also helped to stabilize gasoline prices, since imported oil is paid in USD. Although administrative methods restrained the growth of prices for the time being, should world oil prices continue to increase, setting a price ceiling will lead to an undersupply of oil products on the domestic market.

Agriculture. Meat prices continued to increase in April, which led the Government to intervene in the market. Along with economically justified steps such as attempting to reduce import tariffs and thus stimulate imports, the Government intervened directly by purchasing meat for the State Reserves at specified low prices. This meat is intended to be sold through the network of Ukrainian Cooperative Union shops. Although the idea seemed reasonable, the execution was ineffective. As first tenders have shown, there were very few suppliers willing to sell meat to the state since the set purchase price was well below market price. Besides, the local authorities are entitled to monitor prices daily and establish market trade places for meat producers. Overall, most of government efforts to reduce prices seem ineffective and are often inconsistent with market principles.

Infrastructure. The Cabinet of Ministers increased the railway freight transportation tariffs on a temporary basis until the end of June 2005. Most tariffs for domestic transportation were raised by 50%, while those for export transportation by less than 50%. Tariffs were also increased for first class passenger railway transport. The decision was motivated by the desire of the State Railway Administration (Ukrzaliznytsia) to upgrade train infrastructure. While higher tariffs will allow Ukrzaliznytsia to increase its profits and payments to the state, the tariff setting procedure remained non-transparent and lacked economic grounds.

External Sector: The commodity trade balance remained positive at USD 0.9 bn

The first months of the year revealed that both commodity exports and imports are growing slower than last year. In particular, according to Derzhkomstat, exports of goods increased by 14.7% yoy in dollar terms for January and February, while imports grew by 9.0%. The commodity trade balance remained positive at USD 0.9 bn. In exports, the major contributor to growth was metallurgy, in particular the traditional exports of ferrous metals. At the same time, exports of machinery and equipment have fallen against the background of last year's high statistical base. Most import increases fell to chemical products, machinery and equipment.

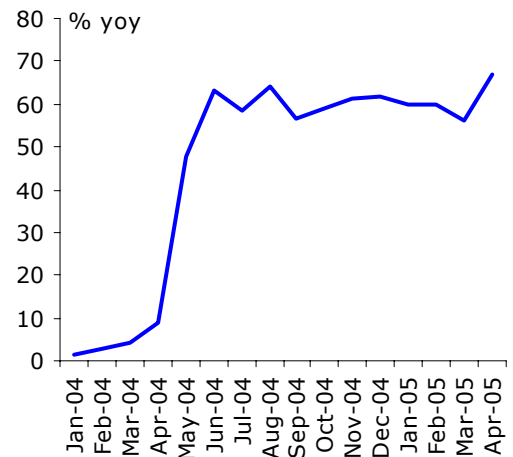
Fiscal policy: The central fiscal revenues were 10% over the budget adopted in 2004

From January to March 2005, the central fiscal revenues reached 110% of the Ministry of Finance's plan established in December 2004, mainly due to good performances of EPT, VAT and import duty. At the same time, the state refund of VAT still remained problematic at 30% level below target. Fiscal expenditures amounted to 92% of the projected level with intergovernmental transfers and social payments being closest to budgeted amounts. As a result, the central fiscal surplus reached UAH 1.9 bn or 2.5% of GDP.

Social policy: Sharp increase in birth grants

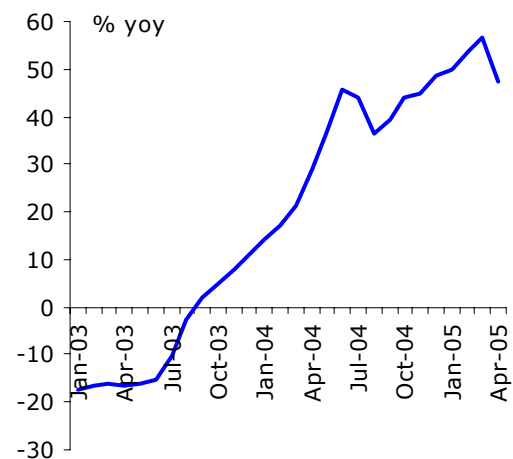
Starting April 1, 2005 birth grants were increased almost 11 times to 22.6 subsistence minimums set for children up to 6 years old, which currently constitute UAH 8497. From the total amount 9 subsistence minimums (UAH 3360) are to be paid immediately, and the rest disbursed during the first years of the child's life. These expenditures

Development of Gasoline Prices in Ukraine



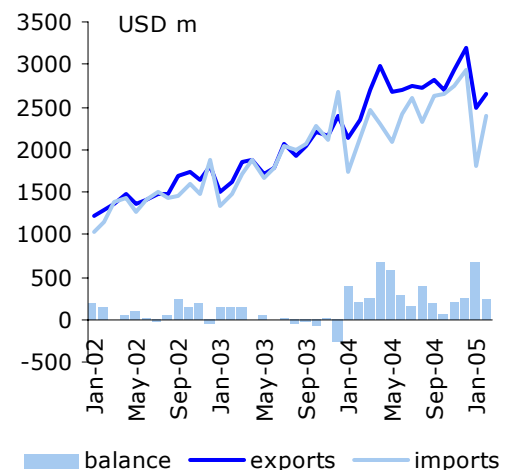
Source: Derzhkomstat

Development of Prices on Meat



Source: Derzhkomstat

Merchandise Trade



Source: Derzhkomstat

are to be financed out of the State Compulsory Insurance Fund in Case of Temporary Loss of Working Ability for insured people, and from the State Budget for those uninsured. The increased birth grants are likely to contribute to solving the country's demographic problem. However, they may create a burden on state finances, since they will require increasing the capacities of hospitals and of kinder-gardens to serve the projected increasing population.

Monetary policy: The NBU undertook monetary toughening measures

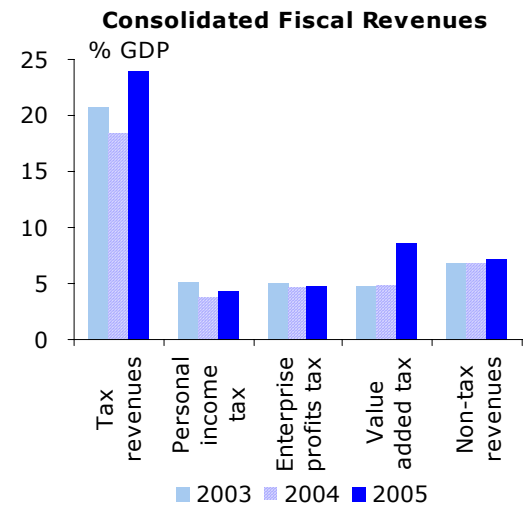
High volumes of foreign currency inflows and the consequent acceleration of the money supply growth induced central bank officials to introduce monetary restraints. In particular, at the beginning of April the NBU set the minimum amount of the daily reserves requirements ratio to 80% of total reserves (up from 60%) and disallowed the inclusion of the banks' vault cash as part of their required reserves. Furthermore, the NBU restricted the banks' access to its standing facility by raising the requirements for collaterals acceptable for refinancing loans. These two measures, as well as the sharp revaluation of the hryvnia that recently took place, resulted in a reduction of the excess liquidity in the banking sector and, consequently, to a deceleration of the money supply growth rate to 41.3% yoy compared to 45.5% yoy for the last months.

The consumer price inflation remained at the high level of 14.7% yoy in April despite the Government's efforts to reduce prices on selected products, especially meat and gasoline. It is likely that the revaluation of the hryvnia will help to reduce inflation by reducing prices on imported goods (including energy) and by lowering the growth of the money supply. However, it will not be able to cure the structural problems at certain markets nor lessen the consequences of the fiscal expansion that fuelled the inflation in the first place.

Financial markets: The hryvnia was abruptly revalued to 5.05 UAH/USD

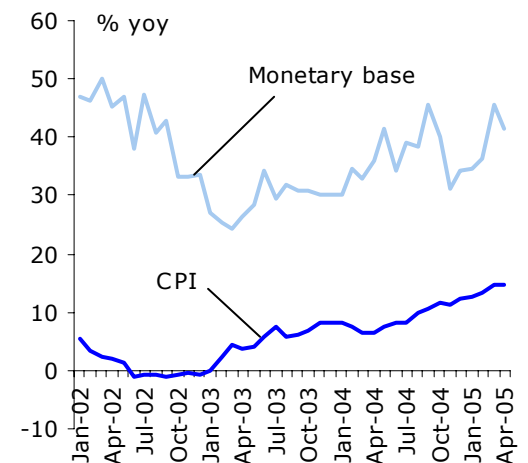
Foreign exchange market. After keeping the hryvnia at almost constant level for 5 years, the NBU abruptly raised the value of the national currency from about 5.25 to 5.05 against the US dollar in mid April, with the aim of reducing the inflationary pressures on the economy through cheaper imports and a lower growth in the money supply. Economic fundamentals for a hryvnia revaluation were obvious for quite some time in light of the huge current account surplus and overall macroeconomic stabilisation. On the real economy side, the revaluation is expected to dampen exports and stimulate imports, resulting in a decreased commodity trade surplus and a likely slowdown of economic growth. The sudden appreciation of the hryvnia adversely affected the wealth of many Ukrainians who hold savings in foreign currency or whose salaries are pegged to dollar. However, this should induce people to switch from foreign to national currency, thus fostering the de-dollarization of the economy.

Government debt market. The Ministry of Finance has conducted a massive restructuring of its debt portfolio. It has reduced its debt to the NBU by half (UAH 3.2 bn) through the early redemption of variable rate domestic government bonds (POVDP) with maturities between 2005 and 2010. The Ministry of Finance financed this transaction through sales of new issues of domestic government bonds (OVDP) in April 2005. According to ministry officials, as the POVDPs are relatively more expensive for the government than the newly issued medium-term bonds (11% p.a. versus 5.5% p.a.), the Government was able to save UAH 0.3 bn thanks to this portfolio restructuring. This assertion remains questionable, however, since usually interest receipts from POVDP become fiscal revenues.



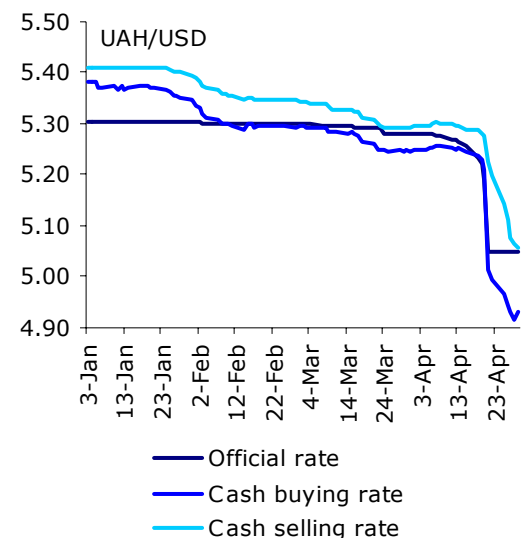
Source: State Treasury

CPI and Monetary Base Development



Source: Derzhkomstat, NB U

UAH/USD Exchange Rate



Sources: NBU, Ukrainian financial server



Economic Trends		Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Jan	Feb	Mar	Apr
GDP growth (real)	% yoy	12.1	12.7	13.7	14.0	8.5	6.5	4.5	5.2	...
GDP growth (real)	% yoy cum.	9.4	12.7	13.2	13.5	12.1	6.5*	5.5*	5.4*	...
Industrial production (real)	% yoy cum.	15.8	18.8	15.9	14.4	12.5	8.4	7.3	7.1	...
Agricultural production (real)	% yoy cum.	-10.2	-4.0	-1.5	24.8	19.4	3.7	3.5	4.5	...
CPI	% yoy eop	8.2	6.6	8.0	10.7	12.3	12.6	13.3	14.7	14.7
PPI	% yoy eop	11.1	18.4	22.4	23.3	24.1	22.6	22.3	22.0	21.1
Exports (USD)***	% yoy cum.	24.0	39.8	44.0	41.0	37.2	16.0"	14.7"
Imports (USD)***	% yoy cum.	28.7	34.6	31.9	28.8	26.0	4.0"	9.0"
Merchandise trade balance	USD bn cum.	-0.27	0.93	2.49	3.26	3.74	0.68"	0.92"
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	10.10	10.94	11.95	13.00
Monetary Base	% yoy eop	30.2	32.7	34.2	45.7	34.1	34.5	36.4	45.5	41.3
Lending rate on UAH credits **	% pa, aop	17.9	17.2	16.6	17.0	17.9'	18.1	16.8	17.0	16.4
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.31	5.31	5.30	5.30	5.29	5.19
Exchange rate (official)	EUR aop	6.34	6.67	6.42	6.49	6.88	6.98	6.89	6.98	6.71

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	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 ^o	1.2 ^{oo}	1.4	3.1	2.9	6.8
Current account	% GDP	-2.7	-3.1	2.9 ^o	3.8 ^{oo}	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 ^{'''}	% 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