

MONTHLY ECONOMIC MONITOR UKRAINE

- During his visit to Kazakhstan Mr. Yushchenko discussed questions of oil supply for Ukraine.
- In the first quarter of 2005 investments in fixed capital increased by a meagre 4.5% yoy.
- The Government reacted to the rising oil products prices by stimulating imports.
- Ukraine signed a bilateral protocol for access to markets of goods and services with El Salvador.
- Real household incomes grew by 24.1% yoy in the first quarter 2005 due to increases in the minimum wage and pensions.
- The banks slowed their lending activities due to investment uncertainties and the revaluation of the hryvnia.
- S&P upgraded Ukraine's sovereign rating to B+.

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June
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 discussed oil supply issues during his visit to Kazakhstan

The President of Ukraine, Viktor Yushchenko, made an official visit to Kazakhstan. The questions discussed included the intensification of cooperation between the two countries in the oil and gas sector, in particular increased oil supplies, as well as oil transportation issues.

The criminal investigations against people within the Kuchma political elite continued in May. The case opened against the Head of the Donetsk Oblast Council, Boris Kolesnikov, was forwarded to court. He is accused of racketeering and abusing his official status. Also, several criminal cases were opened against former officials related to the SDPU(o) party.

Real economy: Investment activities were sluggish during the first quarter of 2005

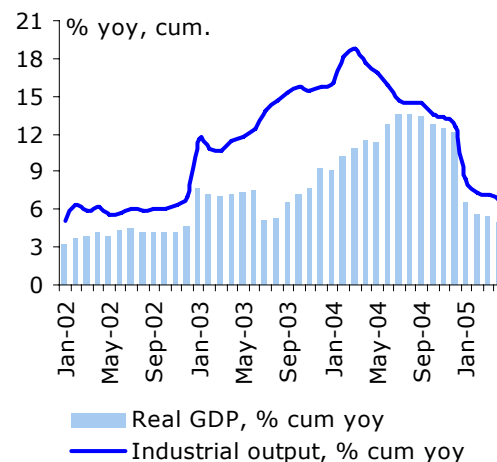
Economic growth continued to slow in April. According to Derzhkomstat, the real GDP increased by 5.0% yoy between January and April. Slower growth of value added in manufacturing, industry and trade, as well as a continued decrease of value added in construction contributed to a moderate pace of the real GDP development. Industrial output increased by 6.7% yoy during the first four months of the year. Stable growth within the food industry and slight growth in machine building only partially counterbalanced the slow development of metallurgy, and the reduction of production in the coke and petroleum refining industries.

In line with expectations, investment activity in the country was sluggish during the first quarter of 2005. Fixed capital investment increased by only 4.5% yoy in real terms compared to 52.1% yoy during the same period of 2004. Among the sectors that experienced reductions in investment flows were agriculture, construction, the hotel and restaurant business, as well as most other service sectors. Investments in industry that constitute 40% of total fixed capital investment grew by a meagre 3.1% yoy compared to 51.2% yoy during the first quarter of last year. This significant slowdown in investments can be attributed to both a high statistical base effect and to uncertainty adversely influencing the business climate. Factors of uncertainty include changes in the political leadership, the tax legislation, the trade regime, as well as the planned constitutional reform and the parliamentary elections. These factors are expected to impede investment activities till the end of the year.

Sectoral trends: The Government tackled the problem of rising oil product prices by attracting imports

Energy. May was marked by sharp increases in oil products prices. This development can be attributed to rising oil prices on the world

GDP and Industrial Output



Source: Derzhkomstat

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markets and to a seasonal increase in domestic demand for oil products that coincided with production interruptions at several oil refineries due to maintenance. The Government coerced the gasoline producers to fix the price of A-95 gasoline at the level of UAH 2.99 per litre, which resulted in a gasoline shortage in mid-May. To tackle the problem the Government reached agreements with some countries (Kazakhstan, Baltic states, Serbia and others) for an urgent supply of oil, and it temporarily abolished the import duty on oil-products in order to promote their inflow. During a high level meeting in the presence of the President of Ukraine, the Prime Minister and representatives of the petroleum refineries, the administrative price fixing was cancelled. As a result, the price for the A-95 gasoline rose to UAH 3.20 per litre and stayed at this level till the end of May.

Privatisation. The privatisation receipts from January to May amounted to about UAH 0.6 bn out of UAH 6.9 bn planned for the whole year. The primary source for this income was the sale of a 39.9% share of the mining complex "Krasnodonvuhillya" at UAH 0.5 bn, which took place in May. Although the January to May privatisation receipts exceeded the plan by 54%, the ability of the Government to raise the rest of the targeted amount looks doubtful. There is no indication that the Government will sell sufficiently large state stakes. Also, the likelihood of receiving additional funds from revisions of previous privatisation agreements is very uncertain.

External Sector: Imports surpassed exports

According to Derzhkomstat, both commodity exports and imports in dollar terms increased in March compared to the previous months. Cumulatively exports increased by 16.8% yoy in dollar terms in the first quarter of the year, while imports grew by 18.5% yoy. Although import growth surpassed export growth, the commodity trade balance remained positive at USD 0.86 bn, slightly above the previous year's figure for the same period. Growth of metal exports in dollar terms remains one of the key factors for high exports thanks to still favourable world metal prices. The import growth is attributed to imports of chemical products, electrical machinery, and mineral products. The latter is explained by growth of coal and ores, while imports of oil and gas was lower than last year. Also, high final household consumption stimulated imports of certain agro-food products and textiles.

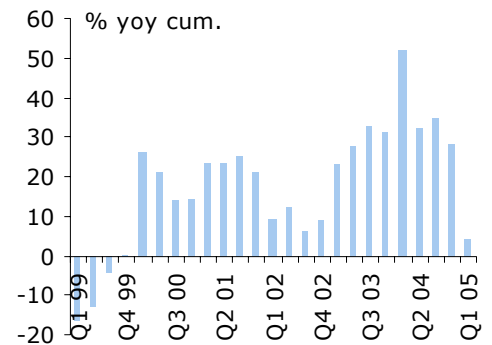
In May Ukraine and El Salvador signed a protocol on access to markets of goods and services within the framework of Ukraine's WTO accession. This is the thirty-first bilateral protocol signed by Ukraine. The country continues negotiations with more than a dozen trade partners including the USA, Australia, Japan, China, Moldova, and Norway. To become a member of the WTO by the end of 2005 – the goal set by the President – Ukraine has not only to complete these bilateral talks, but also to make changes to more than twenty legislative acts in order to bring its legislation into line with the WTO requirements.

The Government abolished the export licensing of iron ore, coal tar pitch, and meat established last year. This is a positive step towards liberalizing Ukraine's trade policies concerning exports. Also, the Government continues to liberalize its import trade regime. In particular, at several border customs a "one-window" system of customs clearance was introduced that should result in considerable transaction cost reductions for importers.

Fiscal policy: Central fiscal surplus was 1.3% of GDP

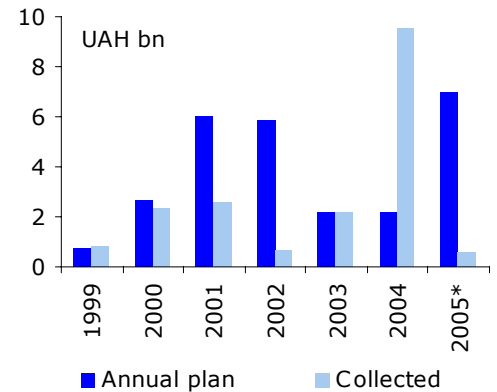
According to Treasury data, from January to April the central fiscal revenues were 9% above plan due to over execution of import duties, excises and VAT, while VAT refunds were at 22% below plan. However, the execution rate seems to be overestimated, since the actual revenues were compared to the budget plan, which does not foresee some 23% higher revenues adopted in March. At the same

Investment in Fixed Capital



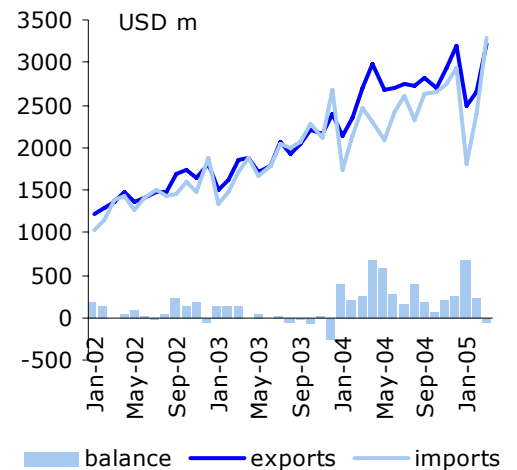
Source: Derzhkomstat

Privatisation Receipts



Source: State Treasury
*collected from January to May

Merchandise Trade



Source: Derzhkomstat

time, the expenditures execution rate of 91% was calculated based on the new expanded plan. The resulting central fiscal surplus is UAH 1.4 bn (or 1.3% of GDP for the period). It is expected that expenditures will increase toward the end of the year, eventually resulting in the planned fiscal deficit. Taking into account that the privatisation receipts may not reach the planned levels, there could be a need to finance the fiscal deficit via increased state borrowings.

Social policy: Real incomes increased by 24.1% during the first quarter 2005

Real household incomes increased by 24.1% between January and March 2005 as compared to the same period of 2004. This high real growth of incomes is largely attributable to higher social assistance payments, primarily pensions. In particular, incomes for social assistance increased by 54.9% yoy, whereas wage incomes grew only by 14.4% yoy in real terms. The average wage in March 2005 was UAH 722, implying a real wage growth of 15.5% yoy. One of the major factors for the growing wage is an increase in the minimum wage that took place in September 2004 and January 2005. The growth of household incomes is likely remain quite rapid since pensioners started to receive increased pensions in April, and the minimum wage is planned to be gradually increased to the level of the minimum pension (UAH 332) by September 2005.

Monetary policy: The growth rate of the money supply slowed in May

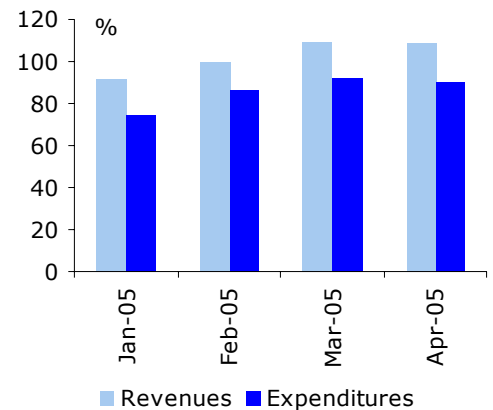
According to the NBU, the May growth rates of the monetary base and the money supply decreased substantially to 32.4% yoy and 35.1% yoy respectively. Consequently, the liquidity of the banking sector reduced as reflected in the development of the overnight interbank interest rate, which increased slightly at the end of May. Three main factors explain this development: a lower supply of foreign currency to the interbank foreign exchange market, monetary toughening measures undertaken by the NBU over the past months, as well as sizeable sterilizations that the NBU performed since the beginning of the year. At the same time, the CPI inflation rate has remained almost unchanged at 14.6 % yoy.

Financial markets: Ukraine's sovereign debt rating was upgraded by S&P

Government debt market. The international credit-rating agency Standard and Poor's upgraded its rating for Ukrainian government bonds. The rating of Ukrainian government bonds, denominated in foreign currency, was raised from BB- to B+, while the rating of domestic currency bonds was upgraded from BB to B+. According to the Standard and Poor's report, the revision was justified by recent improvements in the political situation and the conditions for realizations of market reforms, as well as structural improvements in the taxation system, in particular, the abolition of tax privileges.

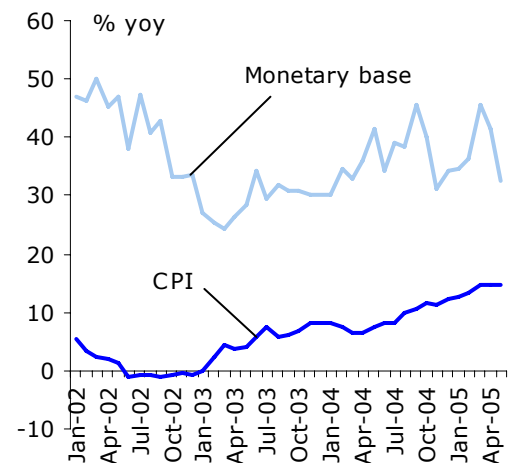
Banking system. From January to May the banking sector continued to show growth in its main indicators. On the liability side, the volume of bank deposits grew by 36.4% yoy, mainly due to inflows of household deposits, which increased by 36.2% yoy. On the asset side, the rate of growth of credits lowered to 33.6% yoy approaching in volume the stock of total deposits. Yet, interest rates continued reduction and constituted 15.9% p.a and 11.3% p.a on hryvnia and foreign currency credits, and 8.3% p.a and 6.3% p.a on hryvnia and foreign currency deposits. The decreased bank lending activities can be explained by the continuing re-privatisation talks that worry investors, as well as by the recent unexpected revaluation of the hryvnia that created a new environment to which banks will have to adjust. It is expected that the UAH/USD exchange rate will remain stable by the end of the year, and that the uncertainty relating to re-privatisation will finish soon, so that the reduction in bank lending will be temporary and will have no significant impact on the banks' profitability and the stability of the system.

Central fiscal execution



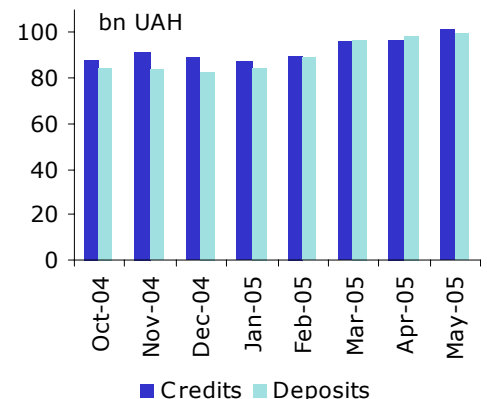
Source: State Treasury

CPI and Monetary Base Development



Source: Derzhkomstat, NB U

Volume of commercial bank credits and deposits



Source: NB U



Economic Trends		Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Jan	Feb	Mar	Apr	May
GDP growth (real)	% yoy	12.1	12.7	13.7	14.0	8.5	6.5	4.5	5.2	3.9	...
GDP growth (real)	% yoy cum.	9.4	12.7	13.2	13.5	12.1	6.5*	5.5*	5.4*	5.0*	...
Industrial production (real)	% yoy cum.	15.8	18.8	15.9	14.4	12.5	8.4	7.3	7.1	6.7	...
Agricultural production (real)	% yoy cum.	-10.2	-4.0	-1.5	24.8	19.4	3.7	3.5	4.5	5.7	...
CPI	% yoy eop	8.2	6.6	8.0	10.7	12.3	12.6	13.3	14.7	14.7	14.6
PPI	% yoy eop	11.1	18.4	22.4	23.3	24.1	22.6	22.3	22.0	21.1	20.5
Exports (USD)***	% yoy cum.	24.0	39.8	44.0	41.0	37.2	16.0"	14.7"	16.8"
Imports (USD)***	% yoy cum.	28.7	34.6	31.9	28.8	26.0	4.0"	9.0"	18.5"
Merchandise trade balance	USD bn cum.	-0.27	0.93	2.49	3.26	3.74	0.68"	0.92"	0.86"
Current account	USD bn cum.	2.89	1.63	3.93	5.62	6.80	x	x	x	x	x
Current account	% GDP, cum.	5.9	13.6	14.7	12.2	10.4	x	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	13.19
Monetary Base	% yoy eop	30.2	32.7	34.2	45.7	34.1	34.5	36.4	45.5	41.3	32.4
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	15.9
Exchange rate (official)	USD aop	5.33	5.33	5.33	5.31	5.31	5.30	5.30	5.29	5.19	5.05
Exchange rate (official)	EUR aop	6.34	6.67	6.42	6.49	6.88	6.98	6.89	6.98	6.71	6.43

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