



Monthly Economic Monitor Ukraine

- Ukraine hosted a round-table organized by the World Economic Forum.
- The growth rate of the real GDP slowed to 4.7% yoy between January and May.
- The 93.02% share of "Kryvorizhstal" was returned to the state ownership.
- Parliament adopted changes to Ukraine's Customs Tariff that envisage significant import tariff rate reductions.
- The central fiscal surplus, calculated on a cash basis, reached UAH 2.7 bn or 1.3% of GDP between January and May.
- The deficit of the Pension Fund was approved at UAH 11.9 bn.
- A private Bureau of Credit Histories was founded in Ukraine.

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July
2004

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

Politics: A big investment forum took place in Ukraine

In June Ukraine hosted a round-table organized by the World Economic Forum, known for conducting the business elite forums in Davos. The round-table, called a mini-Davos in the Ukrainian press, was convened to attract investment to Ukraine and to present the new Ukrainian government and its vision for economic development to an international audience of business people and politicians. Several presidents of other countries, including the presidents of Georgia, Lithuania and Estonia, participated. It is unlikely that the Kiev roundtable will immediately generate new investment, as the business world is still uncertain about some recent developments in Ukraine related to re-privatization and the abrupt legislative changes.

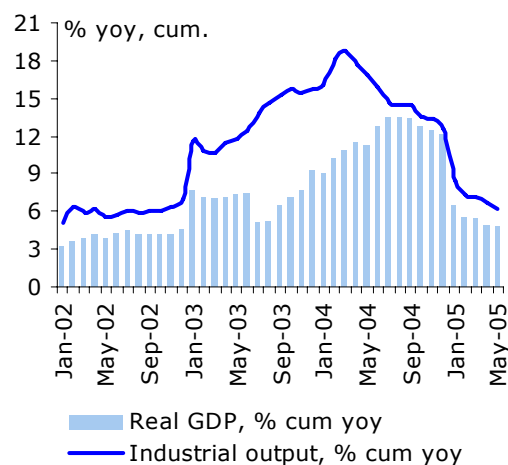
June was also marked by an increasingly tense relationship between Ukraine and the Russian Federation due to conflicts about natural gas. Russia accused Ukraine of stealing about 8 billion cubic meters of gas from underground storage. Somewhat later on the parties agreed that this was rather a political statement, which could not be proven for now. Nevertheless, the conflict was not resolved; and Russia declared its intention to abandon in-kind payments and increase the price for gas supplied to Ukraine more than three fold, from the current \$50 per thousand of cubic meters to \$160. In response, Ukraine expressed its readiness to increase the transit fee for Russian gas to Europe by the same ratio. Agreement on prices that would suit both sides will be difficult, and currently the negotiations are virtually stalled. It may be necessary that further negotiations will require the participation of senior leaders from both countries.

Real economy: The GDP grew by 4.7% yoy between January and May

The decelerating trend of economic growth continued in May. According to Derzhkomstat, the real GDP increased by 4.7% yoy between January and May, that is 0.3 percentage points lower than for the first four months of the year. A persistent negative growth of value added in construction, as well as slower development of value added in industry, transport, and trades made for a low real GDP growth. In particular, value added in the wholesale and retail trades sector rose by only a negligible 0.1% yoy after several years of two-digit growth rates.

The industrial output increased by 6.2% yoy in the first five months of the year, maintaining a decelerating pace. A most significant slowdown was registered in the manufacturing industry, primarily because of reduced outputs in metallurgy and in the production of coke and petroleum products, as well as slow development in machinery building. The real output of metal products, 80% of which are exported, reduced by 0.3% yoy between January and May mainly due to a decrease in the world demand for metal products.

GDP and Industrial Output



Source: Derzhkomstat

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Sectoral trends: “Kryvorizhstal” was returned to state ownership

Privatization. The 93.02% share of the largest Ukrainian metallurgical enterprise “Kryvorizhstal” was returned to state ownership following a decision of the Commercial Appeals Court. Expecting that the Commercial Appeals Court decision will be upheld by higher courts, the Government ordered the State Property Fund to start preparing new tenders for a privatisation to be held prior to November 20, 2005. Meanwhile, with the state being the major shareholder the shareholders meeting decided to pay out “Kryvorizhstal” profit in the form of dividends. As a result, the state will receive about UAH 0.7 bn of revenues.

Agriculture. Sugar prices have surged in an unforeseen manner over the last four months. Wholesale prices increased by 34% reaching UAH 3300/t, resulting in retail prices of UAH4300-4500/t. Several factors led to this price increase. First, striving to protect domestic producers the Verkhovna Rada had banned the privileged import of cane sugar in 2005 and left the production quota for the domestic market at 1.8 m tons. In addition, amendments to Budget 2005 closed the doors to imports through the Special Economic Zones. According to expert estimates, the actual domestic demand for sugar is about 2.2 m tons, resulting in a deficit of some 0.4 m tons. If the state continues its protectionist policies, the price of sugar could rise even more, since a poor sugar beet harvest is expected this year.

External sector: The Verkhovna Rada took another step towards liberalizing imports

Continuing the process of trade liberalization, the Parliament adopted changes in Ukraine’s Customs Tariff in June, which envisage a significant reduction and unification of import tariff rates for more than half of all traded commodities. The reductions do not impact on agriculture and food products, goods subject to excise, and any goods whose import tariffs had already been reduced in March 2005. The Government claims that these import tariff reductions cover the 2004 consolidated tariff proposal offered by Ukraine during its WTO accession negotiations. Lowering tariffs is a positive step that could benefit domestic consumers of final and investment goods, as well as enhance efficiency in the economy by fostering competition over the long run.

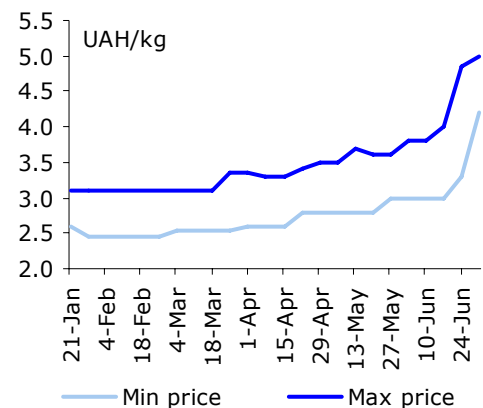
According to Derzhkomstat, commodity exports grew by 12.4% yoy in dollar terms from January to April, while imports grew by 22.9% yoy. The trade balance remained positive, but reduced to USD 0.8 bn as compared to the USD 1.5 bn in the first four months of 2004. Import tariff liberalisation together with a world demand deterioration for the key Ukrainian export product, metals, could cause the commodity trade balance to turn negative later this year.

According to the NBU, in the first quarter of 2005 the current account balance was USD 1.7 bn, being fairly close to the USD 1.6 bn figure registered for the same period of the previous year. Increases in both commodity exports and imports of almost 17% yoy resulted in a commodity trade balance of USD 1.0 bn. The inflow of foreign direct investment (FDI) into Ukraine was USD 249 m, i.e. USD 85 m lower than in the first quarter of 2004. The FDI decrease can be attributed to political uncertainties and to changes in the business climate that characterized the beginning of the year in Ukraine. It is expected that although the FDI may increase somewhat later this year, noticeable positive changes in FDI inflows are likely to occur only after the parliamentary elections of 2006.

Fiscal policy: The central fiscal revenues are 7% over budgeted amounts

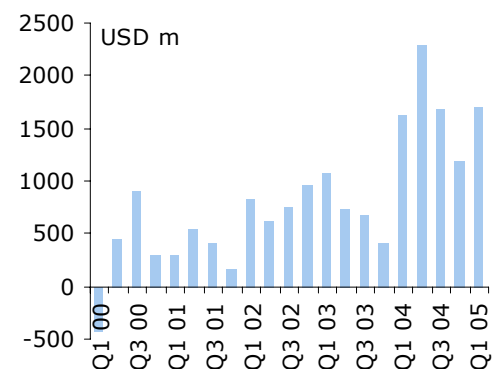
Between January and May the central fiscal revenues were 7% higher than foreseen in the budget, mainly due to an over-execution of VAT, EPT, and excises by 14%, 18%, and 4% respectively. The

Development of Retail Prices on Sugar in 2005



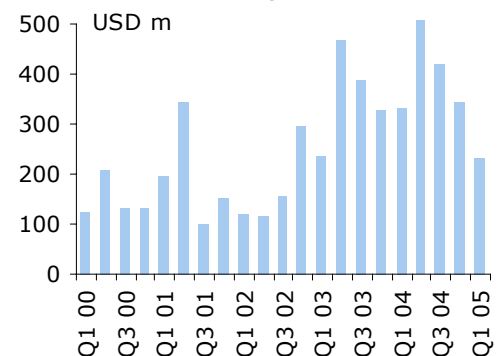
Source: APK-Inform

Current Account Balance



Source: NBU

Foreign Direct Investments Inflow



Source: NBU

higher than planned tax revenues are partially explained by rising VAT refund arrears that reached UAH 3.5 bn at the end of May, and by the imprecision and instability of the tax legislation, which forced some enterprises to pay taxes at the maximum rate. The central fiscal expenditures reached 92% of plan. The highest execution rates were observed in the fields of social security and welfare (97%), and intergovernmental transfers (103%). The resulting fiscal surplus reached UAH 2.7 bn, or 1.9% of GDP.

Social policy: The Pension Fund deficit was approved at the level of UAH 11.9 bn

The Government approved the budget of the Pension Fund for 2005. The Pension Fund expenditures increased by 69% (compared to 2004) to UAH 61.1 bn (or 14% GDP). The total amount to be transferred to the Fund from the State Budget will be UAH 18.6 bn or 16.3% of central fiscal expenditures. Of this, UAH 6.7 bn will be directed to cover the state's pension programs, while UAH 11.9 bn will be directed to the Fund's deficit. The high deficit is due to the necessity to finance the increases for the minimum pensions that took place in September of 2004 and throughout 2005. It is likely that the practice of social expansion will continue in 2006 as the Budget Resolution envisages further growth in the level of the subsistence minimum and, thus, of minimum pensions. This will further raise the burden on next year's budget and will seriously limit the possibility of reducing the excessively high level of pension contributions paid by both employers and employees.

Monetary policy: Major monetary and exchange rate indicators revised

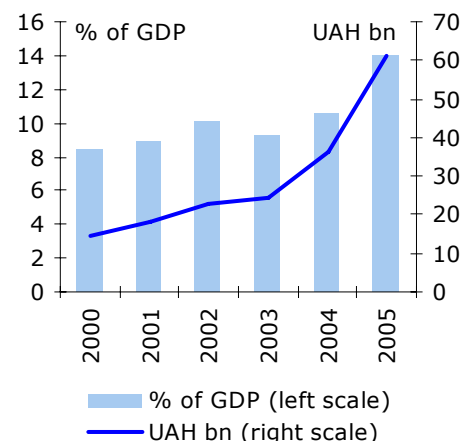
According to NBU officials, the projected yearly growth rates of the monetary base and money supply were revised upwards to 38-43% and 40-45% respectively. However, the volume of the money supply expected at the end of 2005 was left almost unchanged at UAH 176-182 bn, since the money stock at the beginning of the year was lower than initially planned. The projected level of the average UAH/USD exchange rate was also revised from 5.27-5.32 UAH/USD to 5.10-5.15 UAH/USD. The revised figures are consistent with current developments in the monetary and exchange rate sectors and indicate that during the second half of 2005 the UAH/USD exchange rate is likely to remain stable and the monetary policy rather loose. In June, the growth rates of the monetary base and the money supply were 38.7% yoy and 37.2% yoy respectively.

The consumer price index (CPI) grew by 14.4% yoy. This time the CPI was driven by the rapid sugar price growth caused by seasonal imbalances at the market and over-protectionist government policies. Other contributors to inflation were higher tariffs on municipal transportation and other services. It is very unlikely that the government forecast of an inflation rate of 9.8% for 2005 will be achieved. Should the state raise the electricity and gas tariffs for households and further increase the transportation tariffs as is currently planned, the CPI inflation rate could exceed 14%.

Financial markets: The Bureau of Credit Histories was created in Ukraine

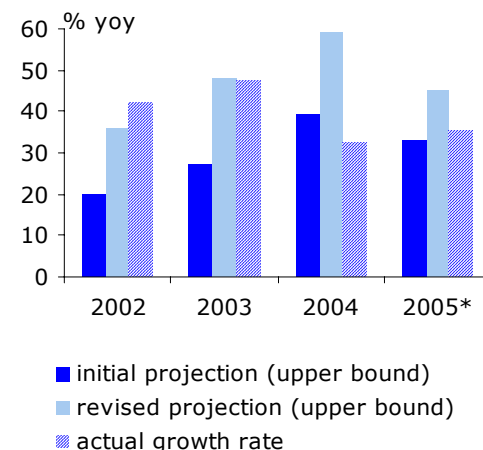
Banking sector. The first private credit histories bureau in Ukraine was founded by two insurance companies and thirty commercial banks, which currently control over 65% of the retail lending market. In its first stage of operation the Bureau will collect and exchange information on individuals and small businesses, while later on the database will be extended to also cover the credit histories of legal entities. The Bureau aims at reducing credit risks by providing lenders with information on the loan repayment performance of borrowers. Yet, the Bureau will start functioning only after the Parliament has approved the necessary legislation, namely the law "On the Establishment and Circulation of Credit Histories" that sets the basic rules to be followed.

Expenditures of the Pension Fund



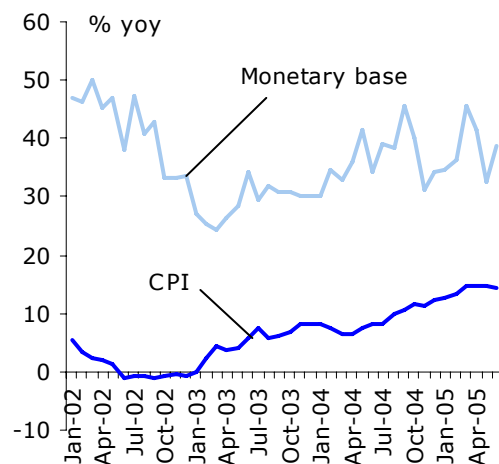
Source: the Ministry of Labor and Social Policy, Resolutions of CMU

Projected and Actual Growth Rates of Money Supply



* Actual growth rate as of the end of June 2005
Sources: NBU Council, NBU

CPI and Monetary Base Development



Source: Derzhkomstat, NBU



Economic Trends		Q1 04	Q2 04	Q3 04	Q4 04	Q1 05	Feb	Mar	Apr	May	Jun
GDP growth (real)	% yoy	12.7	13.7	14.0	8.5	...	4.5	5.2	3.9	3.6	...
GDP growth (real)	% yoy cum.	12.7	13.2	13.5	12.1	...	5.5*	5.4*	5.0*	4.7*	...
Industrial production (real)	% yoy cum.	18.8	15.9	14.4	12.5	7.1	7.3	7.1	6.7	6.2	...
Agricultural production (real)	% yoy cum.	-4.0	-1.5	24.8	19.4	4.5	3.5	4.5	5.2	5.4	...
CPI	% yoy eop	6.6	8.0	10.7	12.3	14.7	13.3	14.7	14.7	14.6	14.4
PPI	% yoy eop	18.4	22.4	23.3	24.1	22.0	22.3	22.0	21.1	20.5	17.7
Exports (USD)***	% yoy cum.	39.8	44.0	41.0	37.2	16.5	14.7"	16.8"	12.4"
Imports (USD)***	% yoy cum.	34.6	31.9	28.8	26.0	17.0	9.0"	18.5"	22.9"
Merchandise trade balance	USD bn cum.	0.93	2.49	3.26	3.74	1.05	0.92"	0.86"	0.79"
Current account	USD bn cum.	1.63	3.93	5.62	6.80	1.70	x	x	x	x	x
Current account	% GDP, cum.	13.6	14.7	12.2	10.4	10.8	x	x	x	x	x
Gross international reserves	USD bn eop	7.92	9.63	12.11	9.52	11.95	10.94	11.95	13.00	13.19	13.07
Monetary Base	% yoy eop	32.7	34.2	45.7	34.1	45.5	36.4	45.5	41.3	32.4	38.7
Lending rate on UAH credits **	% pa, aop	17.2	16.6	17.0	17.9'	17.0	16.8	17.0	16.4	15.9	15.4
Exchange rate (official)	USD aop	5.33	5.33	5.31	5.31	5.30	5.30	5.29	5.19	5.05	5.05
Exchange rate (official)	EUR aop	6.67	6.42	6.49	6.88	6.95	6.89	6.98	6.71	6.43	6.15

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