



Monthly Economic Monitor Ukraine*

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- An intergovernmental commission was created by Ukraine and Japan.
- Final household consumption was a key factor in the real GDP growth of the first quarter of 2005.
- The Government has adopted a list of enterprises to be privatised in 2005, including some strategic ones.
- The Cabinet of Ministers mandated state agencies to purchase 5.5 m tons of grain of the new harvest.
- Parliament passed several key laws within the framework of the WTO accession.
- The central fiscal surplus was UAH 1.1 bn or 0.6% of GDP for January to June.
- Wage arrears grew by 20.7% - now totalling UAH 1.3 bn - during the first half of the year.
- The public debt decreased by 6.9% during the first half of 2005.

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%

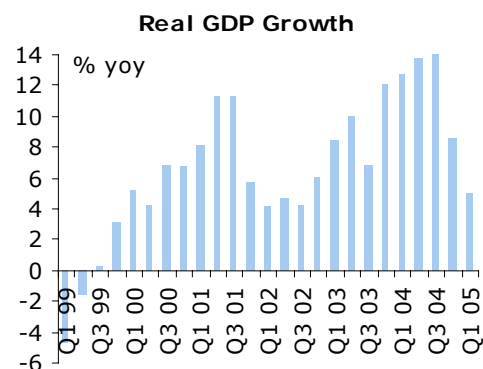
Politics: An intergovernmental commission was created by Ukraine and Japan

The President of Ukraine, Viktor Yushchenko, made an official visit to Japan at the end of July. During this visit an intergovernmental Ukraine-Japan commission was created, headed by the foreign ministers of the two countries, with the mandate to stimulate bilateral cooperation. The first meeting of the commission is scheduled for the first half of 2006. The two countries also signed a protocol on access to markets of goods and services within the framework of Ukraine's WTO accession. Other questions discussed during the visit included the prospects of Japan's assistance in developing Ukraine's infrastructure sector and financial markets, particularly, stock exchange trading.

Real economy: The real GDP growth rate figure for the first quarter of 2005 was revised downwards

In July Derzhkomstat issued an update for the real GDP growth during the first quarter of the year. The GDP growth was revised downwards by 0.4 percentage points to 5.0% yoy. Final consumption, primarily household consumption supported by expansionary social and wage policies, was the key factor for the real GDP growth on the demand side. Also, high final consumption stimulated imports that grew by 6.6% yoy in real terms. At the same time, the extremely low investment activity in the country led to an 8.0% reduction in gross capital accumulation. The reduction concerned both components of the indicator: gross fixed capital accumulation and inventories. Exports also slowed to 0.1% yoy because of adverse changes in world conjuncture. Current trends make it very unlikely that the official forecast for a real GDP growth of 8.2% will be realised.

According to Derzhkomstat's preliminary data, the real GDP increased by 4.0% yoy during the first half of 2005, compared to 13.2% yoy growth during the same period last year. Decelerations occurred in the majority of sectors except agriculture, production and distribution of gas, water, and electricity, and certain services. In particular, the value added in construction dropped by 7.7% yoy due to sluggish investment activity, and against the background of the high statistical base of the previous year.



Source: Derzhkomstat

* Note: Starting with the next issue of MEMU the monetary policy and the inflation data, as well as the MEMU section based on these data, will be presented with a one-month delay, since monetary and price indicators are now being released by the statistical agencies after the major parts of the MEMU have been completed. For this reason a monetary policy section is not included in this issue.

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Sectoral trends: The Government has drawn up a list of enterprises to be privatised in 2005

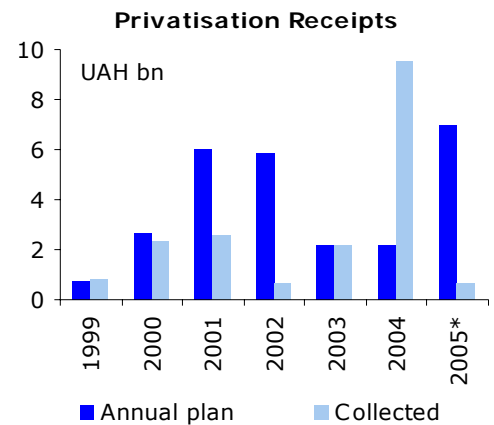
Privatisation. In the first half of 2005 privatisation revenues have amounted to UAH 0.65 bn, i.e. about 10% of the yearly plan. In order to make sure that the yearly privatisation plan of UAH 6.9 bn will be met, the Cabinet of Ministers cancelled the prohibition to privatise strategic enterprises and adopted a list of objects for urgent privatisation. The Government also prepared a time schedule for the sale of 13 enterprises on this list. In particular, privatisation receipts for the Odessa Portside Factory and the Nikopolskiy Southern Pipe Plant are to be received by December. Despite some disagreement between the President and the Cabinet of Ministers regarding the privatisation of Ukrtelecom, it too was included in the new list of enterprises for sale in 2005. It is also envisaged that all enterprises will be sold together with the land, on which they are located.

Agriculture. Concerned that the predicted good grain harvest will lead to a temporary collapse of farm-gate prices, the Government took the decision to support grain producers through pledge-purchase interventions. According to a Cabinet of Ministers decree, state agencies such as the State Reserve, "Khib Ukrayiny", the newly established Agrarian Fund, and local governments are being urged to buy 5.5 m tons of the new grain harvest, which is expected to reach 42 m tons, and this at above-market prices approved by the Ministry of Agrarian Policy. Part of this amount is likely to be exported, as the State Reserve and "Khib Ukrayiny" received significant incentives for exporting, including a reduction of the port and other fees, transport costs, a shortened VAT refund period, etc. Even if the Government allocates funds for this planned purchase - which has not been done so far - it is unlikely that the intervention will significantly affect grain prices as farmers may be reluctant to sell grain to state agencies even at higher prices due to negative experience with payments delays last year. It would be more efficient to use the state funds for improving the infrastructure, which would reduce the traders' costs and thereby increase the farm-gate price.

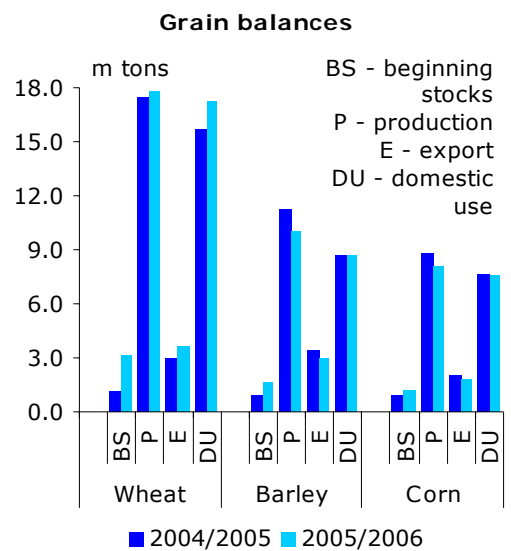
External sector: Ukraine took important steps towards WTO accession

In July Ukraine made considerable progress on its way towards WTO accession. Parliament managed to vote several key laws necessary for bringing Ukrainian legislation in line with WTO requirements. Among others, it adopted a law, strongly advocated by the USA, introducing criminal responsibility for producing pirated CDs; laws removing discrimination from the insurance and auditing markets; laws on reducing agricultural tariffs. Also, Ukraine has signed three more protocols on accession to markets of goods and services with Japan, Norway, and Indonesia, bringing the total number of signed protocols to thirty-four. However, a lot remains to be done to complete all negotiations before the Ministerial Conference in Hong-Kong in December 2005. First, several important laws are still to be adopted by the Verkhovna Rada, including among others laws concerning export tariffs, the sugar market, banking, and harmonizing technical trade barriers with the WTO rules. Moreover, Ukraine still has to complete bilateral negotiations with more than a dozen countries including such key WTO members as the USA and Australia. Thus, Ukraine's chances to become a member of the WTO in 2005 still remain uncertain.

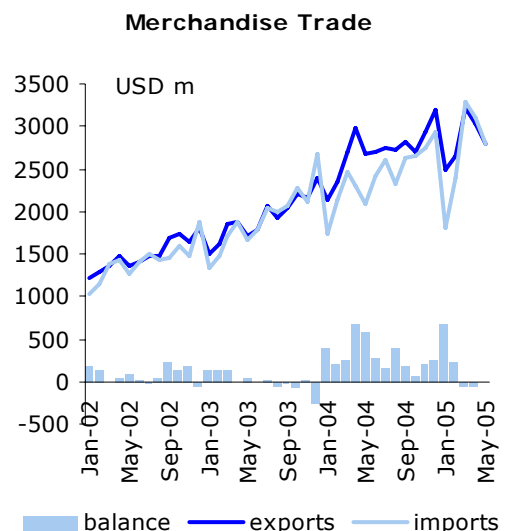
According to Derzhkomstat, exports of goods increased by 10.6% yoy in dollar terms between January and May, while imports grew by 24.9% yoy, considerably surpassing exports. The merchandise trade balance remained positive at USD 0.8 bn, although this is significantly lower than the USD 2.1 bn for the same period last year. Changes in world conjuncture, high domestic demand, a revaluation of hryvnia, and trade liberalisation are among the key reasons for the deceleration of Ukraine's exports and the acceleration of imports.



Source: State Treasury
* collected in the first half of 2005



Source: FAPRI



Source: Derzhkomstat

Fiscal policy: The central fiscal revenues exceeded the targeted amount by 6%

Between January and June the central fiscal revenues were 6% above the target due to good VAT and enterprise profits tax collections, executed at 113% and 116% respectively. The over-execution of VAT was largely due to increased VAT refund arrears that reached UAH 3 bn since the beginning of the year. Thus, the state coffers were filled partially through implicit domestic borrowing from the commercial sector. Fiscal expenditures were 7% below target, which can be explained by technical factors as well as by manual budget execution in the face of fiscal gap threat. The resulting fiscal surplus calculated on a cash basis was UAH 1.1 bn or 0.6% of GDP.

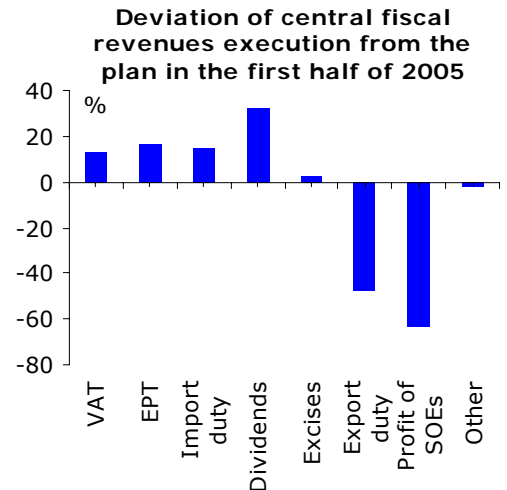
Social policy: Wage arrears grew by 20.7% during the first half of the year

From January to June wage arrears increased by 20.7% and reached UAH 1.3 bn, with the major debtors located in three eastern oblasts: Donetsk, Luhansk and Dnipropetrovsk. State and communal enterprises experienced the highest growth of arrears. Here arrears doubled, although their contribution to the overall growth was small, because this sector's share of arrears in the overall stock of arrears is low. Most of the total wage arrears increase (more than 40%) occurred in agriculture and related service sectors. However, the situation in these sectors is likely to improve in the coming months after the harvest period. Wage arrears also increased significantly in the extractive industry, explaining another quarter of the total wage arrears growth. As in previous years the Government took the decision to help the coal-mining sector by reimbursing wage arrears. The Verkhovna Rada has approved amendments to the State budget that envisages the redemption of wage arrears in the coal-mining sector. Even though this measure aims at reducing the current high social pressure on this sector, such practices cannot be economically justified in the long run, leading to maintaining the status-quo in a poorly managed sector and worsening its payment discipline.

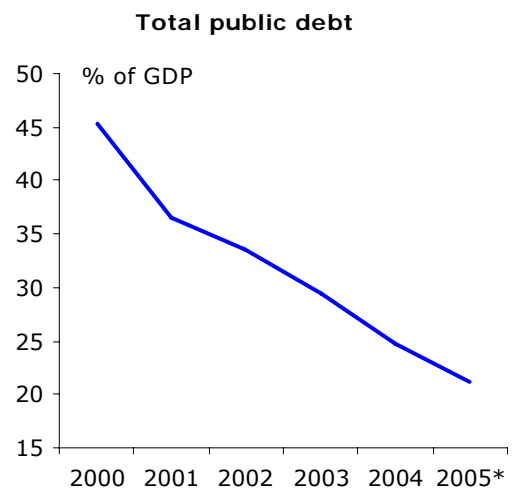
Financial markets: Public debt decreased by 6.9% during the first half of 2005

Government debt market. According to the Ministry of Finance, the public debt decreased by 6.9% during the first half of the year, now amounting to UAH 79.5 bn. As a result, the debt to GDP ratio reduced to 21.2% from 24.8% at the end of 2004. This decline is attributable to the revaluation of hryvnia in April 2005 as well as to the state policy aimed at balancing new borrowings with old debt repayments. At the same time, the structure of public debt has changed in favour of internal borrowing leading to a reduction of Ukraine's external debt by 11.3% and an increase in domestic debt by 6.9% during the first half of 2005. The government's reorientation towards a domestic debt market must be considered a positive development as it reduces exposure of public finances to exchange rate risk.

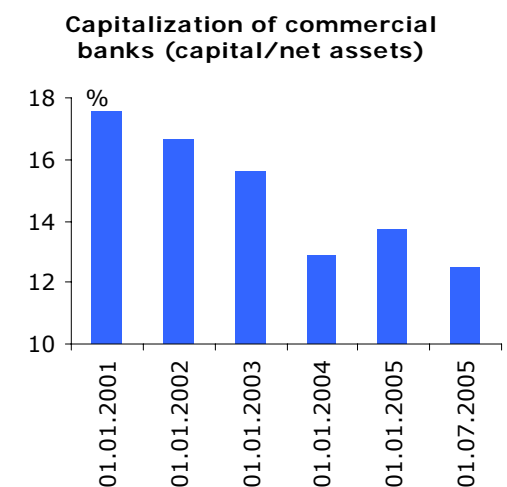
Banking sector. According to the NBU, the build-up of capital by Ukrainian banks during the first half of the year did not keep pace with the asset accumulation. The growth rates of assets and liabilities surpassed that of capital resulting in the fall of the capital-adequacy ratio of the banking sector to 15% at the end of June (from 17% at the beginning of the year). Should this tendency persist, the banking system's stability is likely to be disturbed. Besides, an inadequate capital provision precludes commercial banks from further expanding their credit activity. Low capitalization is also likely to pose a threat to the competitiveness of Ukrainian banks, especially after Ukraine joins the WTO, when liberalized financial markets and the operation of foreign banks branches within Ukraine will be a reality.



Source: State Treasury



Source: Ministry of Finance of Ukraine
* First half



Source: 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	5.0	4.5	5.2	3.9	3.6	1.1
GDP growth (real)	% yoy cum.	12.7	13.2	13.5	12.1	5.0	5.5*	5.4*	5.0*	4.7*	4.0*
Industrial production (real)	% yoy cum.	18.8	15.9	14.4	12.5	7.1	7.3	7.1	6.7	6.2	5.0
Agricultural production (real)	% yoy cum.	-4.0	-1.5	24.8	19.4	4.5	3.5	4.5	5.2	5.4	7.0
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"	10.6"	...
Imports (USD)***	% yoy cum.	34.6	31.9	28.8	26.0	17.0	9.0"	18.5"	22.9"	24.9"	...
Merchandise trade balance	USD bn cum.	0.93	2.49	3.26	3.74	1.05	0.92"	0.86"	0.79"	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