



Monthly Economic Monitor Ukraine

- The President of Ukraine participated in the CIS summit and the meetings concerning the future of the Single Economic Space.
- The real GDP increased by 3.7% yoy during the first seven months of 2005.
- A new privatisation tender for 93.02% of the shares in the metallurgical plant Kryvorizhstal was launched.
- Ukraine and the EU signed a new agreement that regulates their steel trade during 2005–2006.
- Parliament increased the duty on cellular communications from 6% to 7.5% to benefit the Pension Fund.
- The NBU increased refinancing rate and toughened banks' reserve requirements.
- The Austrian Raiffeisen International acquired the Ukrainian Aval Bank and the Ukrainian Processing Center.

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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: Ukraine participate in CIS and Single Economic Space meetings

In August the President of Ukraine participated in the CIS summit and in meetings on further move towards the Single Economic Space (SES) among Ukraine, Russia, Belarus, and Kazakhstan, which had been launched several years ago. Ukraine again reiterated its intension to participate in the SES agreements only to the extent that this does not contradict the country's main goal, i.e. memberships in the EU and the WTO. At this time Ukraine is only ready to sign documents establishing free trade among the countries, but not documents moving them towards a customs union.

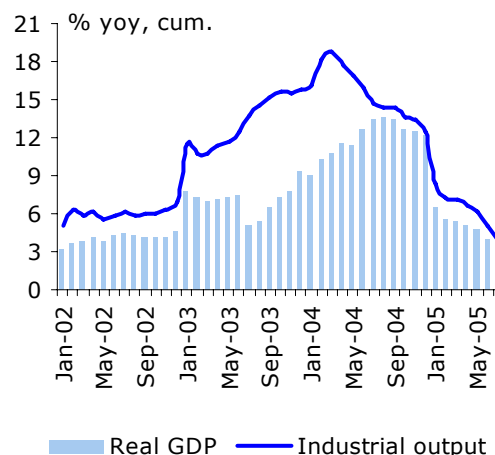
August was marked by intensified Ukrainian-Russian negotiations on gas transit and supply. The main issues discussed were the price of Russian gas for Ukraine, the tariff for transiting Russian gas to Europe, the transit of Turkmen gas through the territory of Ukraine, as well as the usage of underground gas storages and possible mismatch of accounting for such storage. Russia insists that Russian gas in Ukrainian underground storages had been mismanaged, proposes to monetize all payments for gas, which Ukraine currently receives as a barter payment for transit, and insists on increasing the price of gas for Ukraine from the current USD 60 to about USD 150 per thousand cubic meters. So far, no contracts for the 2006 have been officially promulgated, which saddles the Ukrainian economy with uncertainty over the gas price levels for 2006.

Real economy: The economic growth continues to slow

The deceleration of real GDP growth continued in July. According to Derzhkomstat estimates, the real GDP increased by 3.7% yoy during the first seven months of 2005 compared to the two-digit growth rate for the same period of the previous year. A substantial slowdown of the value added growth in manufacturing and negative growth rates in construction and the wholesale trade contributed to the moderate GDP growth on the production side. Industrial output grew by 3.9% yoy, mainly due to reduced metal production and a deceleration in machine building. The strong performance of the food industry was the key contributor to industrial production growth. Taking these trends into account, the Ministry of the Economy revised the annual industrial output forecast for 2005 down to 6.5% from the previous 12.0%, and expressed its intention to downgrade the real GDP forecast as well. According to the revised IER forecast the real GDP will grow by slightly more than 4% in 2005.

Sluggish investment activity is among the major demand-side factors for slowing economic growth. During the first half of the year investments in fixed capital increased by 8.5% yoy that is several times slower than during the same period of 2004. It is expected that strong investment growth will resume only during the second

GDP and Industrial Output



Source: Derzhkomstat

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half of next year, since at present there exist too many uncertainties, including changes in legislation, re-privatization, as well as the forthcoming constitutional reform and parliamentary elections, all adversely affecting the investment climate.

Sectoral trends: The conditions for the new Kryvorizhstal privatization tender were announced

Privatisation. The new privatisation tender for the 93.02% stake of the metallurgical plant Kryvorizhstal is scheduled for October 24, 2005. The starting price is set at UAH 10 bn, compared to the UAH 4.26 bn received for privatising the plant last summer. At present four companies expressed interest in the tender: Mittal Steel (India), Severstal Group and Evrazholding (Russia), and Private Intertrading (Ukraine). The qualification requirements now look less prohibitive than before. Any potential buyer must have at least 3 years' experience in metallurgy or related industries and no less than 1 year of direct control over enterprises in these industries. The buyer must also furnish detailed information on his ownership structure, and cannot be an offshore company. Yet the social, economic and investment obligations have increased significantly. The new owner is obliged to maintain the number of employees at the same level for 5 years, support the current social infrastructure, make tax payments at not less than the plant's average level for 2003-2004, generate income during the next five years of at least UAH 9.5 bn in 2005 prices, and intensively invest in plant reconstruction. These severe economic and investment obligations could frighten potential buyers away, thus reducing the chances for a successful privatization.

External sector: Ukraine and the EU signed a new agreement on steel

After several years of negotiations Ukraine and the EU signed a new agreement that regulates their steel trade in 2005 and 2006. The agreement envisages an increase in the steel quota for Ukraine and leaves the tariff of 30 Euros/ton levied by Ukraine on exports of ferrous scrap unchanged. Reducing the tariff would lead to proportional increases in the quota, up to 43% for a zero tariff. After Ukraine has become a member of the WTO, the quota will be abolished. The agreement denotes important progress in Ukraine-EU relations since steel is one of the key Ukrainian products exported to the EU market, and is at the same time one of the most sensitive products for EU trade.

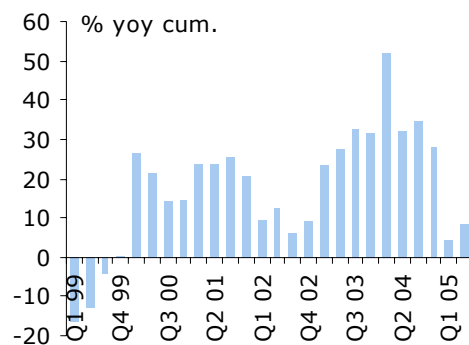
In August Ukraine and China initialled a protocol on access to markets of goods and services, which is intended to be signed as soon as certain technical details have been finalized. Ukraine has now completed bilateral negotiations with 36 countries, but still has to conclude talks with nearly a dozen WTO members including the USA and Australia. In August the USA ended its trade sanctions against Ukrainian products that were imposed in 2002 to compensate for damages incurred due to the low level of intellectual property rights (IPR) protection in Ukraine. This will improve the prospects for signing a bilateral protocol within the framework of the WTO negotiations. To become a WTO member in 2005, Ukraine also has to complete the harmonization of its legislation, and agree to the final report of the WTO Working Party.

According to Derzhkomstat, commodity exports grew by 9.2% yoy in dollar terms during the first half of the year, while imports increased by 26.0% yoy. The commodity trade balance still remained positive at USD 0.4 bn, being almost USD 2 bn lower than at the same time last year.

Fiscal policy: Over-execution of central fiscal revenues continues

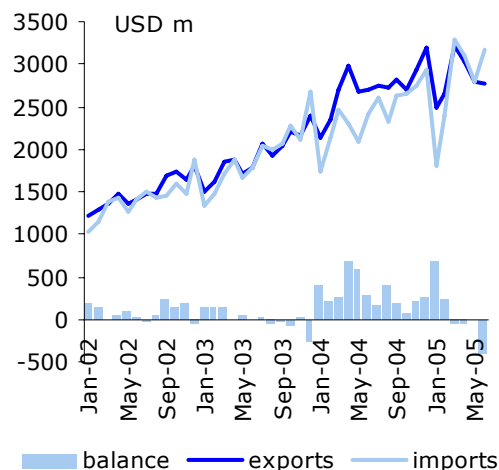
Between January and July the central fiscal revenues were 7% above the target. The major factors influencing the volume of central fiscal revenues include higher legal imports, changes in the legislation that temporarily abolished VAT privileges for small enterprises, an accumulation of VAT refund arrears (exceeding UAH 3 bn as of the

Investment in Fixed Capital



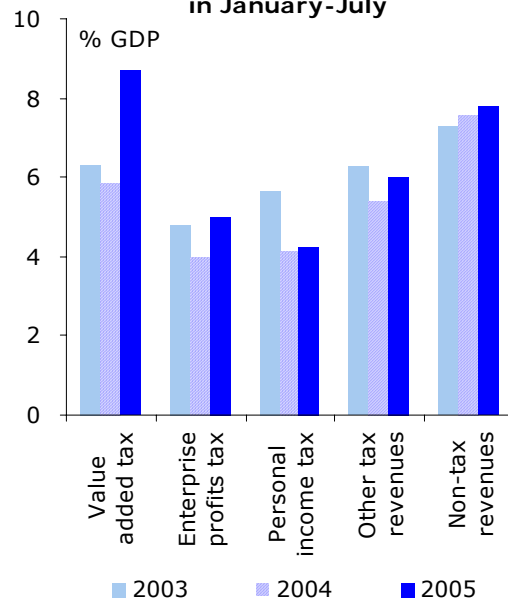
Source: Derzhkomstat

Merchandise Trade



Source: Derzhkomstat

Consolidated Fiscal Revenues in January-July



Source: State Treasury

beginning of the year) and a sharp increase in EPT advance payments. Also, the dividends paid by state owned enterprises were 1.5 times above projected levels. Central fiscal expenditures reached 93% of projected levels, and the central fiscal surplus calculated on a cash basis reached UAH 2.2 bn (1% of GDP).

Social policy: Parliament increased the duty on cellular communications to help the Pension Fund

To sustain the foreseen level of pensions, the Pension Fund continues to accumulate funds from different sources. As of July, the state had transferred UAH 13.2 bn to the Fund, amounting to 71% of the total transfers foreseen for 2005. Nevertheless, the Pension Fund should have more specific dedicated sources of revenues in future. For this purpose Parliament increased the rate of duty paid on cellular communication from 6% to 7.5% in July. The increase in the minimum wage to UAH 310 in July and to UAH 332 in September will also help to raise the Fund's income.

Monetary policy: NBU toughens monetary policy

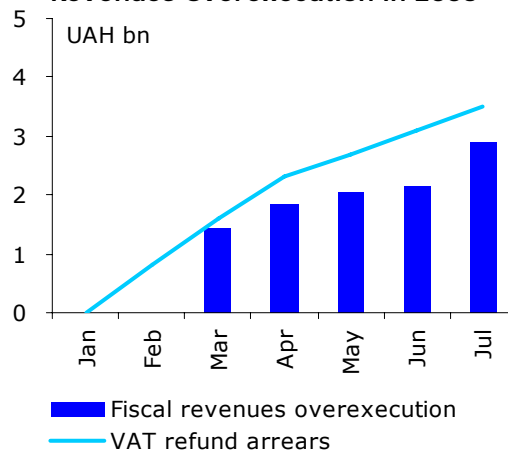
In July the growth rates of the monetary base and the money supply were 30.2% yoy and 35.9% yoy respectively. According to the NBU, the slowdown of the growth rates of the monetary aggregates was to a large extent explained by an accumulation of funds in the Treasury Account. Notwithstanding these dynamics, the NBU undertook several monetary tightening measures in August. Aside from increasing its refinancing rate by 0.5% to 9.5% p.a. in early August, the NBU toughened the reserve requirements. Starting on September 1 the reserve requirement ratio for all demand deposits is raised from 7% to 8% and requirements for the daily amounts held by banks on correspondent account were hardened. According to the official explanation, these steps are aimed at curbing the accelerating inflation. However, their effectiveness in combating inflation is questionable, since so far the monetary influence on inflation in Ukraine has been very limited. Nevertheless, these measures will reduce banks' liquidity, which for a long time was excessive, and increase banks demand for refinancing loans thereby helping the NBU to gain more control over the money market through refinancing policy.

In July the CPI growth accelerated to 14.8% yoy. The continued increase in prices of food products, in particular, meat and meat products remains the major contributor to inflation. In addition, seasonal summer decrease in prices for fruits and vegetables was counterweighted by a sharp rise in sugar prices by 24.1% in July. Taking into account the rapid growth of gasoline prices observed in August it is unlikely that the inflation rate will fall below 14% by the end of the year.

Financial markets: The Austrian Raiffeisen International acquired the Ukrainian Aval Bank

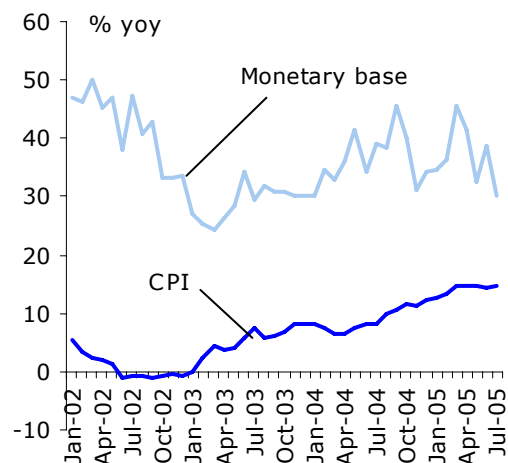
Banking sector. After months of negotiations Raiffeisen International Bank-Holding AG (Vienna) became the owner of a 93.5% share of Aval (Kiev), the second largest Ukrainian bank. Aval has a wide network of branches consisting of more than 1300 establishments and has been actively promoting retail-banking services. Together Aval and Raiffeisen Ukraine, a subsidiary of Raiffeisen International, will own the largest share in Ukraine's bank market with around 12%. According to Raiffeisen International, the two banks will be managed separately, although the possibility of a merger will be considered in the near future. In addition to this deal, Raiffeisen International announced that the talks on acquiring the Ukrainian Processing Center (UPC) were also completed. The UPC is an independent centre that services credit and debit card transactions for more than 30 Ukrainian banks, and is certified by Visa International, MasterCard, American Express, and Diners Club. The two acquisitions make Raiffeisen a very strong player in Ukraine's banking market that might force other large banks either to grow stronger or to look for foreign partners.

VAT Refund Arrears and Central Fiscal Revenues Overexecution in 2005



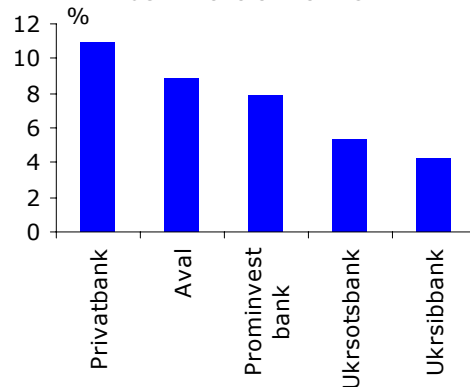
Source: State Treasury

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

Market Shares of the Largest Commercial Banks*



*by assets, as of 01.01.2005
Source: NBU



Economic Trends		Q2 04	Q3 04	Q4 04	Q1 05	Q2 05	Mar	Apr	May	Jun	Jul
GDP growth (real)	% yoy	13.7	14.0	8.5	5.0	...	5.2	3.9	3.6	1.1	2.4
GDP growth (real)	% yoy cum.	13.2	13.5	12.1	5.0	...	5.4*	5.0*	4.7*	4.0*	3.7*
Industrial production (real)	% yoy cum.	15.9	14.4	12.5	7.1	5.0	7.1	6.7	6.2	5.0	3.9
Agricultural production (real)	% yoy cum.	-1.5	24.8	19.4	4.5	7.0	4.5	5.2	5.4	7.0	7.2
CPI	% yoy eop	8.0	10.7	12.3	14.7	14.4	14.7	14.7	14.6	14.4	14.8
PPI	% yoy eop	22.4	23.3	24.1	22.0	17.7	22.0	21.1	20.5	17.7	15.7
Exports (USD)***	% yoy cum.	44.0	41.0	37.2	16.5	...	16.8"	12.4"	10.6"	9.2"	...
Imports (USD)***	% yoy cum.	31.9	28.8	26.0	17.0	...	18.5"	22.9"	24.9"	26.0"	...
Merchandise trade balance	USD bn cum.	2.49	3.26	3.74	1.05	...	0.86"	0.79"	0.79"	0.38"	...
Current account	USD bn cum.	3.93	5.62	6.80	1.70	...	x	x	x	x	x
Current account	% GDP, cum.	14.7	12.2	10.4	10.8	...	x	x	x	x	x
Gross international reserves	USD bn eop	9.63	12.11	9.52	11.95	13.07	11.95	13.00	13.19	13.07	13.63
Monetary Base	% yoy eop	34.2	45.7	34.1	45.5	38.7	45.5	41.3	32.4	38.7	30.2
Lending rate on UAH credits **	% pa, aop	16.6	17.0	17.9'	17.0	15.4	17.0	16.4	15.9	15.4	15.2
Exchange rate (official)	USD aop	5.33	5.31	5.31	5.30	5.10	5.29	5.19	5.05	5.05	5.05
Exchange rate (official)	EUR aop	6.42	6.49	6.88	6.95	6.43	6.98	6.71	6.43	6.15	6.09

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

mom month on month change

qoq quarter on quarter change

yoy year on year change

eop end of the period

aop average of the period

gs goods and services