



Monthly Economic Monitor Ukraine

- Parliament approved Mr. Yekhanurov as Prime Minister.
- The real GDP growth slowed to 2.8% yoy for the first eight months of 2005.
- Receiving UAH 8.1 bn in privatisation revenues in 2006 seems doubtful.
- Parliament approved the 'Law On Automobile Roads', which defines the rules for establishing toll roads.
- Ukraine completed bilateral negotiations on access to markets of goods and services with Iceland and Peru in the framework of the WTO accession.
- The central fiscal deficit for 2006 is projected to be 1.9% of GDP.
- In August the NBU refinanced the Ukrainian commercial banks with UAH 4.3 bn to insure their liquidity.
- The NBU approved regulations concerning the liberalisation of the foreign exchange market.

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2005

Population: 47.3 m
Industry/GDP: 28.7%
Agriculture/GDP: 10.8%
Investment/GDP: 20.1%
Exports to: Russia 18%, EU 29%
Imports from: Russia 40%, EU 32%

Politics: Parliament approved Mr. Yekhanurov as Prime Minister

September was marked by the first political crisis after the Orange revolution. The implicit conflict within the Orange revolution team came out into the open. Several top-level officials, including the State Secretary, Oleksandr Zinchenko, and the Vice Prime Minister for Humanitarian issues, Mykola Tomenko, resigned explaining their decisions with the pervasive corruption surrounding Mr. Yushchenko. To resolve the crisis, the President, Mr. Yushchenko, ousted the Cabinet of Yulia Tymoshenko, and also removed many other officials.

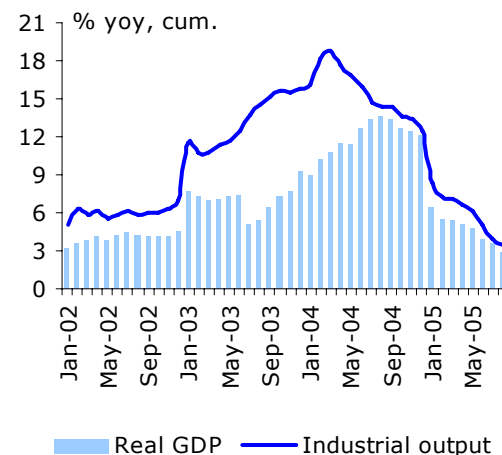
After a failed first attempt and only after Mr. Yuschenko signed a memorandum of agreement with the opposition party (Regions of Ukraine), the Parliament accepted Mr. Yuriy Yekhanurov as Prime Minister. About two thirds of the ministers of the previous Government stayed on. The people's deputy Stanislav Stashevkiy was appointed as First Vice Prime Minister. The position of the Vice Prime Minister for European Integration was eliminated. Ukraine also received a new Minister of the Economy in the person of Arseniy Yatseniuk, who had been the Acting Head of the NBU during the Orange Revolution and performed well solving liquidity problems. New Ministry for Construction, Architecture and Communal Services was created. Anatoliy Kinach, a former Vice Prime Minister, became the new Head of the Council for National Security and Defence replacing Petro Poroshenko.

Real economy: Real GDP growth slowed to 2.8% yoy

According to Derzhkomstat, the real GDP increased by a very moderate 2.8% yoy during the first eight months of the year, continuing the deceleration started at the end of 2004. Together with the ongoing slowdown of value added growth in manufacturing and services, the value added in agriculture also slowed in August. The grain harvest in 2005 is expected to stay at last year's level, thus making only a marginal contribution to the rise in agricultural value added. The negative growth rates in construction and the wholesale trade have also pushed the real GDP growth downwards. Our forecast was revised downwards to capture current trends. The revised figure for the real GDP growth in 2005 is 3.5%.

Between January and August industrial output has slowed to 3.5% yoy compared to 15.0% for the same period of the previous year. The deceleration concerns both the extractive and manufacturing industries, being only slightly compensated by increased production of electricity, water and gas. The lion's share of the slowdown in industrial output is explained by dropping metal production (-3.2%

GDP and Industrial Output



Source: Derzhkomstat

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yoy) and a slow machine-building sector (6.6% yoy). These two sectors account for approximately 40% of total industrial output.

Sectoral trends: Privatisation receipts in 2006 are planned at UAH 8.1 bn

Privatisation. The Draft State Budget 2006 envisages privatisation receipts of UAH 8.1 bn. Receiving this amount seems doubtful, primarily because of the political uncertainty related to the Parliamentary elections in 2006. Also, Parliament recently adopted amendments to the privatisation legislation, which substantially limit the possible privatisation of strategic and public enterprises.

Only 10% (UAH 0.7 bn) of the 2005 privatisation plan has been met by September 2005. Still, it is likely that the goal will be met by year's end, since the announced tender for selling the metallurgical enterprise Kryvorizhstal is expected to bring in above UAH 10 bn.

Infrastructure. Parliament adopted the 'Law On Automobile Roads', which allows common usage roads to be transferred into 'concessions'. The Government is now empowered to make decisions on creating toll roads, provided that they are substantially upgraded and alternative roads are built. Toll roads will remain state property and are not subject to privatisation. According to the Law, all fees collected on such roads are to be part of central fiscal revenues and must be used to service loans taken out for road reconstruction, and for road maintenance.

External sector: Ukraine took further steps towards WTO accession

In September Ukraine completed bilateral negotiations on access to markets of goods and services with Iceland and Peru. Thus, the total number of countries with which Ukraine has concluded talks reached 38. Also the Verkhovna Rada has enacted legislative changes to bring Ukrainian sanitary, phyto-sanitary and veterinary controls into line with WTO requirements. However, to complete negotiations prior to the Ministerial Conference in Hong-Kong in December 2005, Ukraine still has to finalize bilateral talks with ten countries, including the USA, Australia, Egypt, Armenia, and Kyrgyzstan; and to complete the harmonization of its legislation concerning - among others - the reduction of export tariffs and the liberalization of the sugar market.

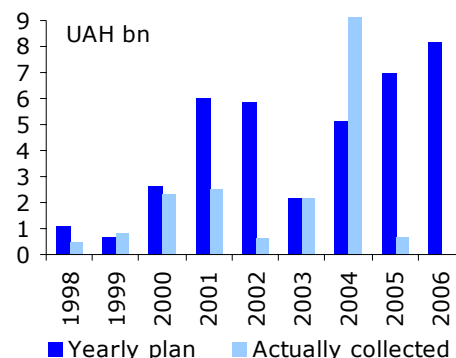
According to the NBU, the current account surplus for the first half of 2005 was USD 2.3 bn compared to USD 3.9 bn for the same period of 2004. The lower value is explained by a deteriorating merchandise trade balance, which in the second quarter turned to a negative USD 0.3 bn. The unfavourable world conjuncture on metal markets, the revaluation of the hryvnia, and liberalization of the import regime account for these changes.

Between January and June Ukraine received USD 0.6 bn of FDI that is nearly 40% less than during the same period in 2004. Uncertainties that hamper investment activity in the country ('re-privatisation', political risks, changes in tax and trade legislation) affect foreign investments. The FDI inflow is likely to remain low till the end of the year, unless privatisation receipts will come from foreigners.

Fiscal policy: The central fiscal deficit for 2006 is projected at 1.9% of GDP

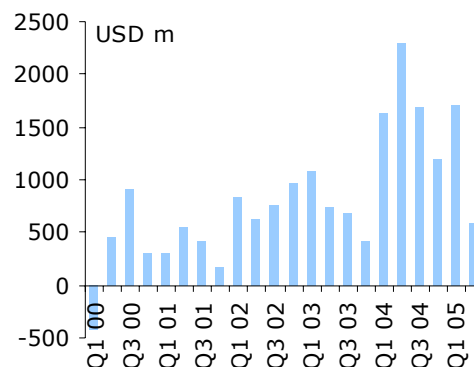
The Government submitted to Parliament the Draft State Budget 2006, which projects the central fiscal revenues to be UAH 118 bn (23.2% of GDP), while expenditures are foreseen at UAH 127 bn (24.9% of GDP). The resulting deficit is 1.9% of GDP. These parameters are based on an optimistic macroeconomic scenario (7% real GDP growth and 8.7% inflation), raising risks for meeting the targets set. The economic structure of next year's State Budget remains the same as in 2005 attributing around 80% of total expenditures for consumption purposes. One of the positive features of the Draft is the broad tax base. The debate over the State Budget 2006 in Parliament is promising to be hot.

Privatisation Revenues



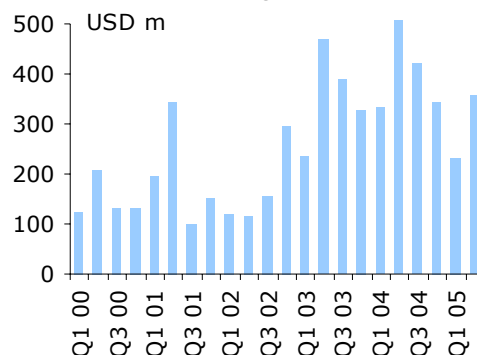
Source: State Treasury

Current Account Balance



Source: NBU

Foreign Direct Investments Inflow



Source: NBU

A further accumulation of VAT refund arrears (UAH 2.6 bn as of September 1) and advanced payments of the enterprise profit tax made for the over-execution of the central fiscal revenues, which in the first eight months of 2005 were 7% above the target. The profits of state-owned enterprises were received at only 46% of plan. Despite the high revenues, the central fiscal expenditures were executed at only 94%. Social welfare expenditures and transfers to local governments had the highest levels of execution (98% and 104% respectively). The under-execution of expenditures is mainly attributed to lower than planned debt service payments (83%) and slow implementation of investment projects. The resulting central fiscal surplus reached UAH 5.2 bn or 2% of GDP.

Social policy: Social standards will be increased in 2006

The Draft State Budget 2006 foresees further increases in the social standards. The subsistence minimum is planned to be raised gradually during the year. This will cause an increase in the minimum pension, which is tied to the level of the subsistence minimum set for individuals who are unable to work. Other social assistance payments, like the assistance to low-income households, will be also increased. The minimum wage will be gradually increased to UAH 400 by the end of 2006, although this will still lag behind the subsistence minimum. The increases in social standards will be largely inertial to satisfy the present legislation, which was adopted for political rather than economic reasons.

Monetary policy: The NBU turned to its refinancing tools

In August the commercial banks experienced a lack of liquidity, which resulted in a growing overnight interbank interest rate, while significant amounts of funds were accumulated in the Treasury Account (UAH 10 bn). Thus, after a long period of sterilization policy, the NBU turned to its refinancing tools in August and provided the banks with UAH 4.3 bn to support their liquidity. At the same time, to ease inflationary pressures the NBU restricted the banks' access to its standing facility. The August growth rates of the monetary base and the money supply were 29.6% yoy and 35.7% yoy respectively.

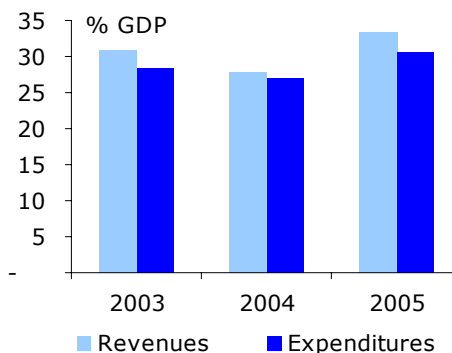
The NBU Council approved the 'Main Guidelines of Monetary Policy for 2006', which foresee much lower growth rates for the monetary aggregates for 2006 compared to 2005. It is expected that the money supply will grow by 27-32% yoy in 2006 (40-45% yoy in 2005). The Head of the NBU declared that two-thirds of the money creation would take the form of medium-term refinancing loans to finance investment projects in the real sector. Decisions such as this one reappear from time to time. They open the door for corruption and are harmful to the economy, since they contribute to higher interest rates for long-term hryvnia credits and to lower investment.

In August the consumer price index (CPI) increased by 14.9% yoy, although it equalled to 0% mom. The inflation was driven by rising prices for fuel and services, in particular increased tariffs on electricity, gas, water and public transportation. At the same time, the food price index reduced slightly because of a decline in sugar prices after several months of spurious growth. The lower sugar prices are explained by supplies from the new harvest.

Financial markets: Foreign exchange operations were liberalised

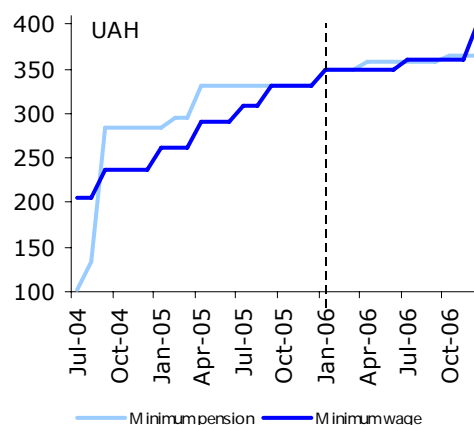
Foreign exchange market. In September the NBU lifted a number of restrictions on foreign exchange operations. Particularly, it allowed arbitrage operations, i.e. the sale and purchase of the same currency during one trading session, and forward operations with most of the solid currencies. Forward contracts can be signed for a period of up to 1 year and within the limit of a bank's open currency position. At the same time, the NBU toughened the total limit of the banks' open currency position to 30% (from 35%). In spite of this liberalisation, the attractiveness of the allowed foreign exchange operations for the commercial banks remains eroded by the 1.5 duty payable to the Pension Fund required on all non-cash foreign exchange operations.

Consolidated fiscal execution for 8 months



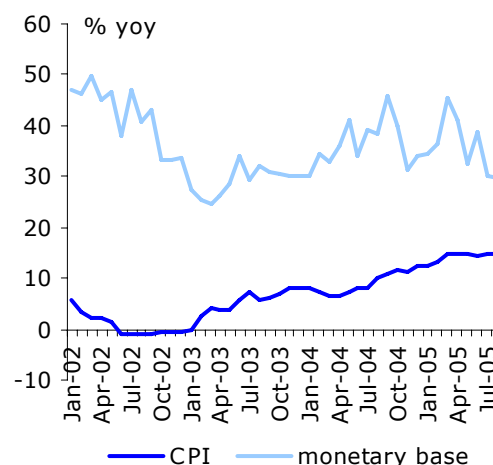
Source: State Treasury reports

Monthly minimum pension and minimum wage



Source: Legislation of Ukraine

CPI and Monetary Base Development



Source: Derzhkomstat, NB U



Economic Trends		Q2 04	Q3 04	Q4 04	Q1 05	Q2 05	Apr	May	Jun	Jul	Aug
GDP growth (real)	% yoy	13.7	14.0	8.5	5.0	...	3.9	3.6	1.1	2.4	-1.6
GDP growth (real)	% yoy cum.	13.2	13.5	12.1	5.0	...	5.0*	4.7*	4.0*	3.7*	2.8*
Industrial production (real)	% yoy cum.	15.9	14.4	12.5	7.1	5.0	6.7	6.2	5.0	3.9	3.5
Agricultural production (real)	% yoy cum.	-1.5	24.8	19.4	4.5	7.0	5.2	5.4	7.0	7.2	2.5
CPI	% yoy eop	8.0	10.7	12.3	14.7	14.4	14.7	14.6	14.4	14.8	14.9
PPI	% yoy eop	22.4	23.3	24.1	22.0	17.7	21.1	20.5	17.7	15.7	14.7
Exports (USD)***	% yoy cum.	44.0	41.0	37.2	16.5	...	12.4"	10.6"	9.2"	7.6"	...
Imports (USD)***	% yoy cum.	31.9	28.8	26.0	17.0	...	22.9"	24.9"	26.0"	24.3"	...
Merchandise trade balance	USD bn cum.	2.49	3.26	3.74	1.05	...	0.79"	0.79"	0.38"	0.12"	...
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	13.00	13.19	13.07	13.63	14.45
Monetary Base	% yoy eop	34.2	45.7	34.1	45.5	38.7	41.3	32.4	38.7	30.2	29.6
Lending rate on UAH credits **	% pa, aop	16.6	17.0	17.9'	17.0	15.4	16.4	15.9	15.4	15.2	15.2
Exchange rate (official)	USD aop	5.33	5.31	5.31	5.30	5.10	5.19	5.05	5.05	5.05	5.05
Exchange rate (official)	EUR aop	6.42	6.49	6.88	6.95	6.43	6.71	6.43	6.15	6.09	6.21

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