



MEMU Supplement No. 10-2005

New Government - new hopes?

The President, Mr. Yushchenko, ousted the Cabinet of Ms. Tymoshenko, and also removed many other officials. After a failed first attempt, Parliament accepted Mr. Yushchenko's choice of Yuriy Yekhanurov as Prime Minister. About two thirds of the ministers of the previous Government retained their seats. Although a Cabinet change is quite common in most European countries, Ukraine reacted strongly to this event, since it brought the implicit conflict within the Orange revolution team out into the open.

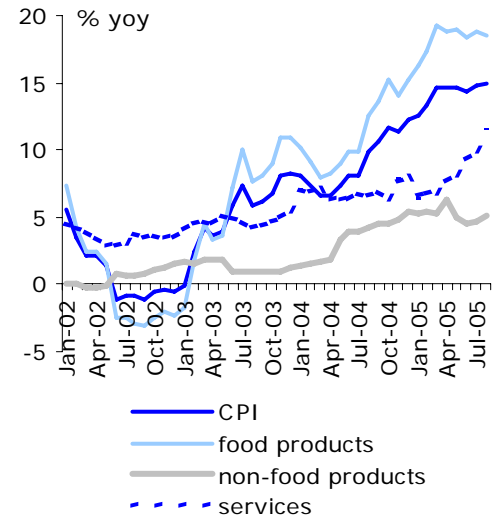
The reasons behind the Cabinet dismissal are closely related to the Parliamentary elections in 2006 and to disturbing signs of slowdown in the Ukrainian economy. The Tymoshenko's Cabinet managed to achieve some success by increasing the real incomes of people, levelling the playing field for all economic actors by closing down the free economic zones, and eliminating many special privileges and subsidies. However, the Government made no efforts to correct many of its serious miscalculations in the economic field, though they were criticized both inside and outside the country. The Government's privatisation reassessment could not succeed with various oligarchs challenging each other's property. Investment growth in the country deteriorated. The people's increased incomes were not matched by increased supplies of goods because of import barriers and the inability of the domestic sector to meet the higher demand, which transformed into inflationary pressure. Some high-level administrative intrusions into the functioning of the markets, led - among other things - to a gasoline shortage in the country, which lasted for several weeks.

Another reason for Ms. Tymoshenko's dismissal is connected to the Parliamentary elections in 2006 and to growing discord among the main heavyweights of Ukrainian politics, which became obvious for the general public and the international community. Ms. Tymoshenko's public support ratings grew sharply during her stay in office mostly due to what many have called her populist stance. Forceful public relations campaigns denied as non-existent or unworthy of attention many of the Government's faults, which therefore were never corrected. Also, the discord between major political figures that became public in Ukraine started to call the smooth functioning of Government into question. For these reasons the Cabinet dismissal as well as the dismissal of certain key political players was met with relief by investors and businessmen alike, and was greeted with a calm understanding by the international community. However in Ukraine it caused much uncertainty, since many Ukrainians took this dismissal as the extinction of the great hopes raised by the Orange revolution.

The newly appointed Government with its intrinsic constraints will be in power until the elections. There are several tasks, which the new Government needs to take care of. The Budget 2006 has to be adopted. The Government will be pressured by various interest groups to return privileges and subsidies, increase social payments, and generally raise fiscal revenues incomes and expenditures – all that based on the excessively optimistic macroeconomic forecast, which underlies the first draft of Budget 2006. There are still several bills to be passed through Parliament, which are required for Ukraine's WTO accession. A decent end to the 'reprivatisation' process must be found and belief in market economy principles must be restored. Also, it is vital to cooperate with Russia in the gas sector, and to correct all misunderstandings, which might harm Ukraine's image as a reliable business partner.

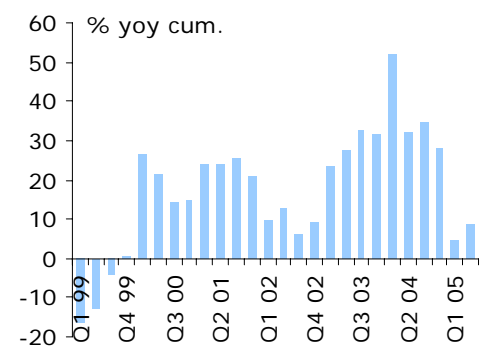
In general, the recent Government change gives the new Cabinet the chance to correct the mistakes of the previous one, while avoiding destabilizing the country by a Parliamentary campaign. However, the success of this endeavour will depend on the ability of the Government not to get too involved in the political process, concentrating instead on the technical issues that need to be solved urgently.

CPI and Components Development



Source: Derzhkomstat

Investment in Fixed Capital



Source: Derzhkomstat

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Quarterly Trends

National accounts **		Q1 03	Q2 03	Q3 03	Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Q1 05	Q2 05
GDP	UAH bn	51.5	60.0	75.6	77.1	64.7	79.0	100.5	100.6	82.5	-
GDP (real)	% yoy	8.4	10.0	6.8	12.1	12.7	13.7	14.0	8.5	5.0	-
Households consumption (real)	% yoy	10.2	14.4	11.2	13.6	14.6	16.8	13.1	16.2	16.4	-
State consumption (real)	% yoy	15.0	17.8	19.2	9.0	3.3	1.0	5.0	10.1	5.2	-
Gross fixed capital formation (real)	% yoy	9.0	20.4	24.3	9.0	18.4	6.5	4.6	12.9	-2.6	-
Exports of goods and services (real)	% yoy	9.9	9.8	9.8	11.6	18.1	19.9	10.5	8.6	0.1	-
Imports of goods and services (real)	% yoy	13.8	16.2	17.4	17.7	13.8	7.3	6.7	7.8	6.6	-
Agriculture, hunting, forestry (real)*	% yoy	4.0	-13.7	-22.5	6.7	-4.4	0.9	35.7	9.9	5.9	-
Manufacturing industry (real)*	% yoy	12.0	15.4	23.0	20.1	23.9	16.3	12.5	9.4	7.8	-
Construction (real)*	% yoy	18.2	24.8	30.9	16.9	29.9	30.6	16.4	3.9	-5.9	-
Trade, repair services (real)*	% yoy	7.2	15.1	22.6	29.6	23.6	35.0	2.7	13.7	-1.5	-
Transport (real)*	% yoy	10.0	11.5	15.9	11.7	10.1	8.0	12.3	10.5	7.3	-
Balance of payments											
Current account balance	USD bn	1.1	0.7	0.7	0.4	1.6	2.3	1.7	1.2	1.7	-
Current account balance	% of GDP	11.2	7.0	5.0	3.0	13.5	15.5	8.8	6.2	10.8	-
Trade balance in goods	USD m	309	-42	-155	-381	933	1552	774	482	1051	-
Trade balance in services	USD m	387	399	362	409	332	153	377	270	257	-
Current transfers	USD m	500	526	574	584	475	758	720	623	624	-
Direct investment (FDI)	USD m	238	454	390	329	334	614	422	345	231	-
Portfolio investments	USD m	-825	640	-444	-293	60	-406	781	-511	-114	-
Gross international reserves	USD bn	4.6	6.2	6.7	6.9	7.9	9.6	12.1	9.5	13.1	-
Fiscal indicators											
Consolidated fiscal revenues	% of GDP	31.6	31.7	30.1	28.6	27.2	26.9	26.3	25.9	32.1	35.1
Personal income tax	% of GDP	5.7	5.7	5.3	5.1	4.4	4.1	3.8	3.8	4.3	4.4
Enterprise profits tax	% of GDP	5.7	5.1	4.8	5.0	3.9	4.0	4.1	6.1	4.8	5.9
Value-added tax	% of GDP	6.2	6.3	5.8	4.8	6.2	5.7	5.1	4.1	8.6	9.2
Excise tax	% of GDP	2.1	2.2	2.1	2.0	2.1	2.1	2.0	1.8	2.0	2.0
Consolidated fiscal expenditures	% of GDP	27.7	29.2	27.9	28.8	25.3	26.5	26.8	35.2	28.3	36.4
Current expenditures	% of GDP	na	26.3	24.2	24.3	22.4	22.7	21.7	27.2	26.5	33.6
Capital expenditures	% of GDP	na	3.0	3.7	4.4	2.9	3.8	5.1	8.0	1.8	2.7
Consolidated fiscal balance	% of GDP	3.8	2.5	2.2	-0.2	1.9	0.4	-0.5	-9.3	3.7	1.0
Privatisation receipts	% of GDP	0.6	1.0	1.0	0.8	1.5	3.7	3.5	1.0	0.2	0.6
Labour market											
Average wage (real)	% yoy	12.3	19.1	19.9	14.9	19.9	18.6	14.7	15.4	15.0	19.0
Household income (real)	% yoy	-1.2	8.6	10.0	8.7	11.7	16.3	11.3	16.6	24.0	28.0
Unemployment rate (ILO methodology)	%	9.4	8.8	9.2	9.0	9.3	8.3	8.1	8.7	8.7	-
Banking system											
Monetary aggregate M0	% yoy cum	32.4	37.0	30.5	25.3	29.1	25.6	37.1	27.9	28.2	39.1
Monetary aggregate M2	% yoy cum	47.8	54.6	49.9	47.6	45.4	44.8	51.5	32.3	38.9	37.4
Household deposits in national currency	% yoy cum	73.4	74.7	65.0	66.1	69.4	67.3	67.9	26.2	28.3	31.6
Household deposits in foreign currency	% yoy cum	71.2	70.2	70.4	77.5	67.0	61.7	55.2	54.3	51.8	45.4
Com. bank credits in national currency	% yoy cum	63.7	71.2	73.0	61.7	56.8	52.1	44.3	29.4	28.3	32.6
Com. bank credits in foreign currency	% yoy cum	44.1	48.4	57.7	60.9	63.6	56.2	43.5	32.2	33.1	36.8
Long-term com. bank credits	% yoy cum	110.6	156.4	164.0	157.9	141.7	102.7	82.7	57.1	49.5	53.0
Long-term com. bank credits	% of total	31.3	37.4	40.1	45.0	47.4	49.3	50.9	54.2	54.4	56.1
Average lending rate on national cur. credits	% p.a.	18.0	17.2	17.2	17.7	17.2	16.6	17.0	17.6	17.0	15.4
Average lending rate on foreign cur. credits	% p.a.	12.5	12.6	11.7	10.9	12.2	12.1	12.6	12.2	12.1	11.0

SOURCES: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, IER estimates

* change in value added

** preliminary

Notes:
yoy year on year change

p.a. per annum