



Monthly Economic Monitor Ukraine

- Viktor Yushchenko has dismissed the Prosecutor General, Svjatoslav Piskun.
- The real GDP increased by 2.8% yoy during the first nine months of 2005.
- Mittal Steel Germany GmbH won the 're-privatisation' tender for the metallurgical enterprise Kryvorizhstal.
- The commodity trade balance turned to a negative USD 372 m after the first eight months of 2005.
- Between January and August real household incomes increased by 24.5% yoy.
- The CPI decelerated to 13.9% yoy in September 2005.
- Ukraine successfully issued EUR 600 m of ten-year Eurobonds.

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Politics: Viktor Yushchenko dismissed the Prosecutor General, Svjatoslav Piskun

In October the President of Ukraine, Viktor Yushchenko, dismissed the Prosecutor General, Svjatoslav Piskun. By the end of the month nobody had yet been appointed nor had any candidates for the post of Prosecutor General been proposed. This situation is typical for the Ukrainian political milieu of recent months. Many vacancies remain at various levels of authority; in particular Supreme Court judgeships and ambassadorial posts remain vacant or are filled by 'acting' staff.

The Prime Minister of Ukraine Yuri Yekhanurov visited Turkmenistan to hold trade talks concerning gas from Turkmenistan. The main result of the negotiations was a firm agreement on the price of Turkmen gas in 2006 at USD 44 per thousand m³. However, no solution was reached on a long-term contract, since Turkmenistan desires to hold talks on long-term gas supplies only in the presence of Russia as a third partner.

In October, the President of Ukraine Viktor Yushchenko made an official visit to the United Kingdom holding a meeting with the British Prime Minister, Tony Blair. During the meeting questions of easing visa requirements for Ukrainians, and granting Ukraine the status of a market economy country were discussed. Mr. Yushchenko also met with Queen Elizabeth discussing bilateral Ukrainian-UK relations. The presidential visit to the UK was an important event in Ukrainian foreign politics, because no visit of a President of Ukraine to the UK had taken place since 1995.

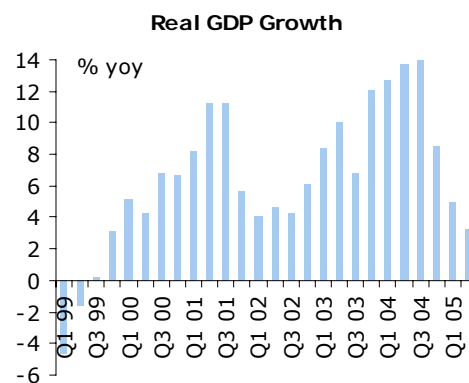
Real economy: The real GDP increased by 2.8% yoy during the first nine months of 2005

During the first nine months of 2005 the real GDP increased by 2.8% yoy, backed by moderate growth of value added in manufacturing, agriculture, and transportation. Negative growth rates of value added persisted in construction and trade.

During the first half of 2005, final household consumption and, to a lesser extent, state consumption have remained the major driving forces for GDP growth on the demand side. During this period, final household consumption increased by 15.4% yoy in real terms mainly due to higher spending on services, including transport, telecommunications, health care, and recreation. Sluggish investment activity in the country resulted in a 1.7% yoy drop in the gross fixed capital accumulation compared to an 11.6% yoy rise during the same period of 2004. The moderate pace of real GDP growth is also linked to lower external demand for Ukrainian goods, reflected in a 6.6% yoy drop of real exports of goods and services. At the same time, domestic demand for imported goods has been steadily growing (4.3% yoy rise in real imports).

The recent wage and social policies of the government resulted in a change in the structure of the value added distribution among

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%



Source: Derzhkomstat

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institutional units in the economy in the first half of 2005. The share of value added directed towards compensation of employees has increased by 1.4 percentage points (to 47.5%). Also, the share of taxes has grown by 0.5 percentage points to 14.0%. As a result, the share of the gross operating surplus – a key source for investment – has reduced to 38.5%.

Sectoral trends: Kryvorizhstal was sold for UAH 24.2 bn

Privatisation. Mittal Steel Germany GmbH won the re-privatisation tender for the metallurgical enterprise Kryvorizhstal, which had been returned to state ownership this year. 93.02% of the shares of this enterprise were sold for UAH 24.2 bn (USD 4.8 bn), which is 6 times higher than the price realised last year. Three contenders took part in the auction: "SmartGroup" (Ukraine), Industrial Group (Ukraine), and Mittal Steel Germany GmbH (Germany). Representatives of the EU deemed the auction to have been the most transparent one over the whole privatization history of Ukraine.

Infrastructure. Profits of the state railway monopoly, Ukrzaliznytsia (UZ) for the first nine months of 2005 were almost 21 times higher than for the same period in 2004, reaching UAH 1.3 bn. This huge increase in profits is mostly due to a 15% rise in UZ's total revenues, and to only a marginal 1.5% drop in total costs. Taking into account the 7% drop in UZ's freight turnover, the financial success is a direct result of tariffs increases. This financial success will allow UZ to make payments to the central government. The success could, however, have negative consequences for future developments, since UZ seems to curb its maintenance spending and reduce its investment activities.

Agriculture. Once again the Verhovna Rada failed to cut the VAT privileges of agriculture. It amended the Law on the VAT, prolonging VAT privileges for agricultural producers until January 1, 2007. The amount of the privilege was UAH 1.2 bn in 2004, which brings distortions to the economy.

Parliament approved a law "On the principles of state agricultural policy", which is the best ever effort to define the economic goals of agricultural policy in Ukraine. Along with food security and agricultural competitiveness, the law emphasises rural development, and reducing rural poverty, thus shifting the stress from agricultural to rural policy. However, the measures foreseen in the law are not appropriate for achieving these goals, since they are based on state (price) supports and interventions.

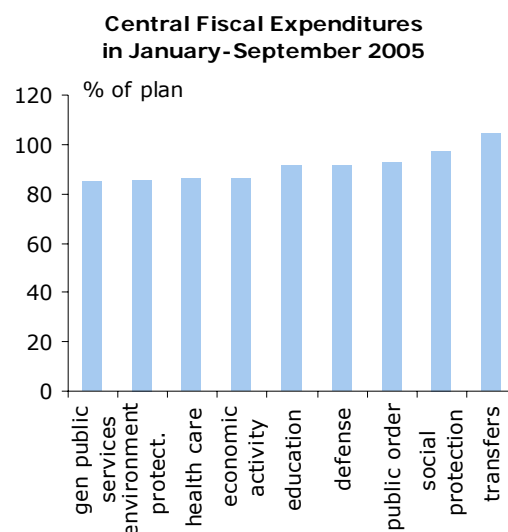
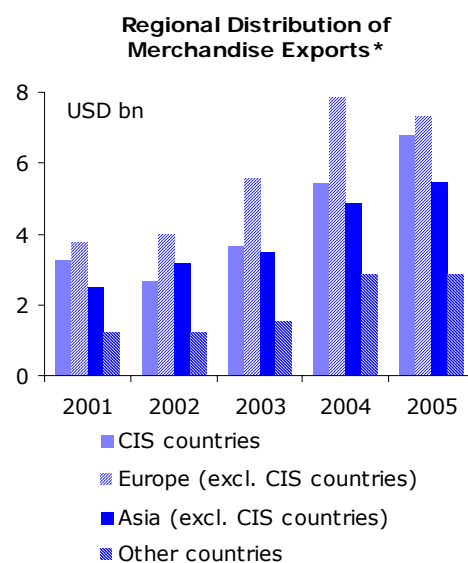
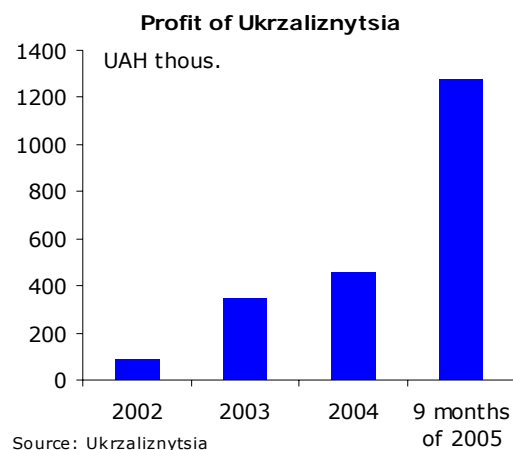
External sector: The commodity trade balance turned to a negative USD 372 m

According to Derzhkomstat, commodity exports increased by 6.8% yoy in dollar terms during the first eight months of 2005, compared to a 47.0% yoy rise for the same period last year. Commodity imports grew by 26.4% yoy in dollar terms. As a result, the commodity trade balance turned negative, at minus USD 372 m.

High growth rates of exports to the CIS and to Asia were to a large degree counter weighed by drops in exports to America and the EU-25. The latter is primarily explained by a significant reduction in exports to Germany, although it has remained the fourth largest recipient of Ukraine's exports. At the same time, trade liberalization and the revaluation of hryvnia stimulated import growth from all regions of the world.

Fiscal policy: The central fiscal revenues are 6% above target

Over-performance of the EPT (118% of projected level) and VAT (115% of target), as well as high VAT refund arrears resulted in continued over-execution of the central fiscal revenues, which between January and September had reached 6% above target. The Treasury reports VAT revenue over-execution at UAH 3.2 bn (1.3% of GDP). At the same time, the accumulated VAT refund arrears amounted to UAH 2.3 bn as of October 1, even though they had



slightly reduced from the UAH 2.4 bn figure as of September 1. The execution rate of government's revenues from profits of state-owned enterprises have further decreased compared to earlier on this year and now constitute 43% of plan. Despite the high revenues, the central fiscal expenditures were only executed at 95%. The resulting central fiscal surplus has reached UAH 3.2 bn or 1.3 % of GDP.

In October, the Parliament failed to adopt the draft law "On the State Budget for 2006", which had been either submitted by the Cabinet of Ministers in September or which had already included Parliament's suggestions. Instead, the draft law was turned back to the Budgetary Committee of Parliament for further work. The revised draft law was approved in the first reading on November 1.

Social policy: During first eight months of 2005 real household incomes grew by 24.5% yoy

During first eight months of 2005 real household incomes increased by 24.5% yoy. This high real growth is largely attributable to higher social assistance payments. In particular, in August, real incomes received from social assistance increased by 40.1% yoy, whereas real wage incomes grew only by 14.8% yoy. As a result, the August share of incomes from social transfers received by the population slightly exceeded the share of wages. One of the major factors for the growing wages is an increase in the minimum wage from UAH 262 in January to UAH 310 by July. It is expected that average wages will further increase in the last four months of 2005 due to an additional minimum wage rise to UAH 332 in September 2005. However, taking the 2006 parliamentary elections into account, it is likely that social transfers will continue to dominate household incomes in 2006, too.

Monetary policy: CPI decelerated to 13.9% yoy

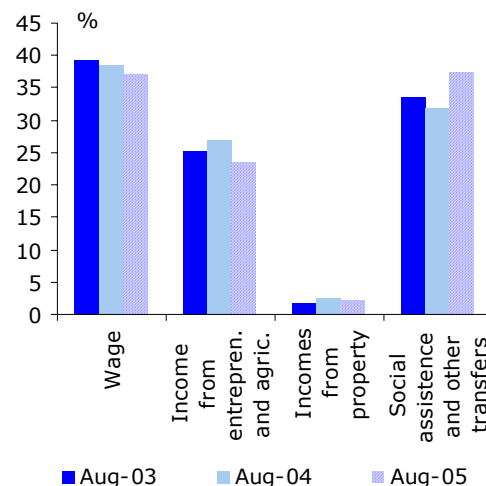
The comparatively low monthly growth of consumer prices in September resulted in a deceleration of CPI growth to 13.9% yoy. Despite a gradual growth in meat and dairy product prices, the continued decline of sugar prices after their sharp rise in the summer led to a reduction of the food price index. A specific feature of the September inflation was increased service prices, in particular, transport tariffs. It is expected that inflation will stay at the two-digit level till the end of the year.

Tightening the monetary policy at the end of August led to a slowdown of the money supply expansion in September. The monetary base and the money supply increased by 27.2% yoy and 31.4% yoy respectively. At the same time, bank lending continued to grow at high rates with household credits expanding by about 79% since the beginning of the year. The commercial banks continued to use the refinancing means of the NBU, which provided them with UAH 1.8 bn to support their liquidity. Owing to the slackening of inflationary pressures in September and the increased demand for financial resources, the NBU did not conduct sterilization operations during the month.

Financial markets: Ukraine successfully issued EUR 600 m of Eurobonds

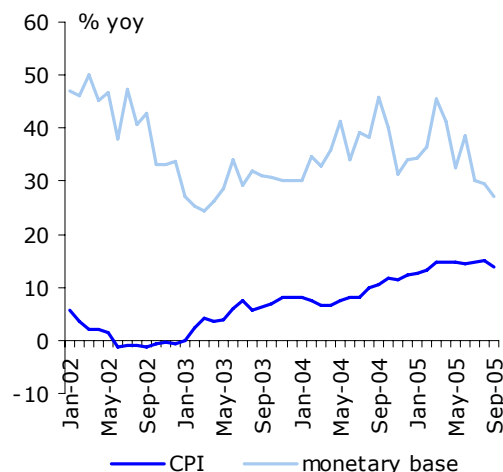
State debt. At the beginning of October Ukraine successfully issued EUR 600 m of Eurobonds with a ten-year maturity and 4.95% yield. This is the lowest yield for Ukraine's Eurobonds ever. The rating agency Fitch assigned a BB- rating to this issue of Eurobonds. Also, in late October the Kyiv municipal administration sold USD 250 m of ten-year Eurobonds with a 7.98% yield (the fiscal revenues of Kyiv City in 2005 are approximately USD 1 bn). The money raised from this issue will mainly be spent on infrastructure development. The successes of both issues reflect the optimistic expectations of investors and the attractiveness of the Ukrainian economy despite the recent slowdown in real GDP growth and the increased inflationary pressures.

Structure of income of population



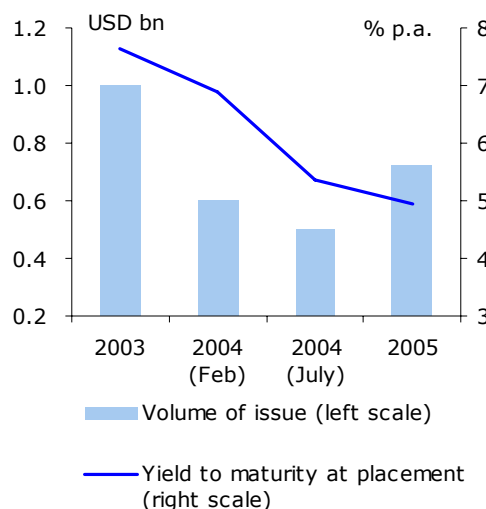
Source: Derzhkomstat

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

Ukrainian Eurobonds issues



Source: Ministry of Finance



Economic Trends		Q3 04	Q4 04	Q1 05	Q2 05	Q3 05	Jun	Jul	Aug	Sep
GDP growth (real)	% yoy	14.0	8.5	5.0	3.2	...	1.1	2.4	-1.6	3.0
GDP growth (real)	% yoy cum.	13.5	12.1	5.0	4.0	...	4.0*	3.7*	2.8*	2.8*
Industrial production (real)	% yoy cum.	14.4	12.5	7.1	5.0	3.2	5.0	3.9	3.5	3.2
Agricultural production (real)	% yoy cum.	24.8	19.4	3.9	6.4	3.4	6.4	6.9	2.2	3.4
CPI	% yoy eop	10.7	12.3	14.7	14.4	13.9	14.4	14.8	14.9	13.9
PPI	% yoy eop	23.3	24.1	22.0	17.7	14.7	17.7	15.7	14.7	14.7
Exports (USD)***	% yoy cum.	41.0	37.2	15.8	10.3	...	9.2"	7.6"	6.8"	...
Imports (USD)***	% yoy cum.	28.8	26.0	17.9	21.9	...	26.0"	24.3"	26.4"	...
Merchandise trade balance	USD bn cum.	3.26	3.74	1.05	0.82	...	0.38"	0.12"	-0.37"	...
Current account	USD bn cum.	5.62	6.80	1.70	2.29	...	x	x	x	x
Current account	% GDP, cum.	12.2	10.4	11.4	6.8	...	x	x	x	x
Gross international reserves	USD bn eop	12.11	9.52	11.95	13.07	14.26	13.07	13.63	14.45	14.26
Monetary Base	% yoy eop	45.7	34.1	45.5	38.7	27.2	38.7	30.2	29.6	27.2
Lending rate on UAH credits **	% pa, aop	17.0	17.9'	17.0	15.4	15.4	15.4	15.2	15.2	15.4
Exchange rate (official)	USD aop	5.31	5.31	5.30	5.10	5.05	5.05	5.05	5.05	5.05
Exchange rate (official)	EUR aop	6.49	6.88	6.95	6.43	6.19	6.15	6.09	6.21	6.19

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