



Monthly Economic Monitor Ukraine

- United States Senate voted for abolition of the "Jackson-Vanick Amendment" for Ukraine.
- The real GDP increased by 2.8% yoy during the first ten months.
- Mittal Steel Germany has already paid UAH 24.2 bn for "Kryvorizhstal" *in corpore*.
- The Verkhovna Rada adopted two more laws necessary for harmonization of Ukraine's legislation with the WTO rules.
- Parliament amended Budget Law 2005 and increased the fiscal deficit to 2.2% of GDP.
- Central government transferred additional UAH 2.8 bn to finance deficit of Pension Fund.
- The CPI decelerated to 12.4% yoy in October 2005.
- The NBU tightens the requirements for inside lending by commercial banks

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December
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: United States Senate voted for abolition of the "Jackson-Vanick Amendment" for Ukraine

United States Senate voted for abolition of the "Jackson-Vanick Amendment" for Ukraine. The Amendment was introduced as response of the lack of freedom of emigration in the USSR and limited foreign trade on behalf of the USA. This Amendment still applies to some CIS countries. The abolition of the Amendment is to be also voted by the House of Representatives and signed by the US President. The abolition of Amendment allows extending non-discrimination regime of trade with the USA to all Ukraine's goods.

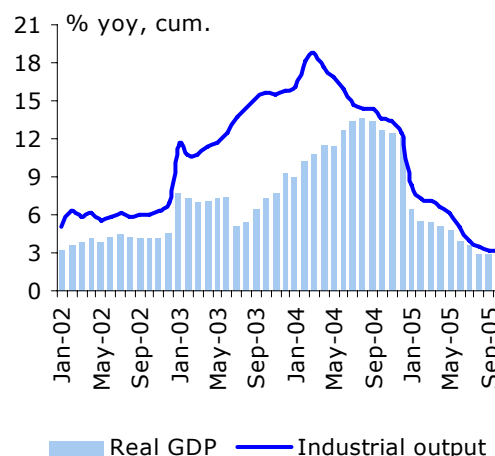
In November Nursultan Nazarbaiev, the President of Kazakhstan, visited Ukraine. One of the important results of his visit was the expression of interest in use of the Odessa-Brody oil pipeline in forward direction and its continuation to the Polish city Plotsk. Readiness of Kazakhstan to supply its oil to fill the pipeline would push the plans on the construction of the remaining part of the pipeline from Brody to Plotsk with possible continuation of the pipeline to the port city Gdansk. This along with rising oil prices can attract investors to build the remaining part of the pipeline.

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

According to the Derzhkomstat, between January and October the real GDP grew by 2.8% yoy compared to the 12.7% yoy rise in the same period of the previous year. The further deceleration of value added growth in agriculture and manufacturing was only partially compensated by higher growth of value added in transport. Drop of value added in construction and wholesale trade persisted. Industrial output increased by 3.1% yoy supported by steady development of food and chemical industries. Low domestic investments and drop in external demand resulted in moderate growth path of machine building, which output increased by 5.2% yoy during the first ten months of 2005 compared to a 32.5% yoy growth in the same period of the previous year.

Reduction of construction output and moderate development of machine building reflect sluggish investment activity in the country. Between January and September investments in fixed capital increased by mere 3.4% yoy compared to 34.5% yoy growth rates in the same period of the previous year. That is explained by high statistical base effect and increased uncertainties associated with forthcoming parliamentary elections and constitutional reform, as well as changes in tax and trade laws. It is expected that investments will remain depressed until the second half of 2006 when political uncertainties will diminish.

GDP and Industrial Output



Source: Derzhkomstat

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Sectoral trends: The Mittal Steel Germany has already paid UAH 24.2 bn for Kryvorizhstal

Privatisation. Ahead of schedule the Mittal Steel Germany has paid *in corpore* UAH 24.2 bn for metallurgical enterprise Kryvorizhstal, privatisation tender for which was conducted in October. The prescheduled payment is explained by willingness of the Mittal to settle export contracts for 2006 in December. The State Property Fund has transferred the 93.02% of shares to Mittal Steel accounts. The NBU has redeemed all US dollars receipts at the exchange rate of 5.00 UAH/USD. The deal on Kryvorizhstal has allowed more than treble privatization receipts compared to plan for 2005.

Telecommunication. The government allowed to re-distribute radio frequency spectrum, transferring frequencies from military to commercial usage. Earlier only 5% of all frequency resources were available to civil usage, yet now around 75% of the spectrum will be converted for non-military needs. This decision will increase the efficiency of frequencies usage and promote development of third generation (3G) mobile services. For now, one frequency for 3G mobile services has already been taken away. Three telecom operators are willing to participate in frequency allocation auction.

The National Commission on Regulation of Communications (NCRC) introduced Internet Protocol (IP) telephony operators' licensing, and has already issued four licenses for provision of international IP-calls. This innovation brings two positive developments into the sector. First, the NCRC established previously missed legislation on IP-telephony. Second, the licensing procedure resolves persistent conflict around unauthorized usage of networks by IP-operators.

External sector: Ukraine continues harmonizing legislation with the WTO rules

Although Ukraine will fail to complete negotiations with the WTO by December Ministerial Conference in Hong-Kong, it still struggles for quick conclusion of accession talks. The Verkhovna Rada adopted two more laws necessary for harmonization of Ukraine's legislation with the WTO rules. In particular, it passed amendments to laws on anti-dumping and safeguard measures. However, ten bilateral protocols are still to be signed including protocols with such key WTO members as the USA and Australia. The cornerstone issue that hampers negotiations is the level of protection in agriculture.

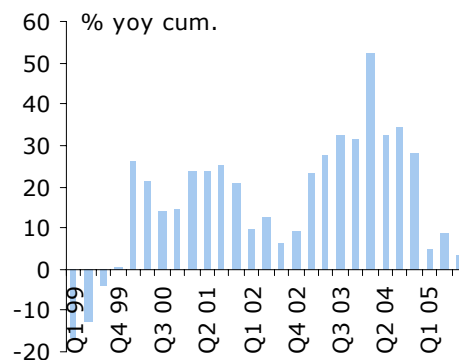
Reduction of import tariff rates and April's revaluation of hryvnia contributed to high growth rate of imports that greatly surpassed the growth rate of exports. According to the Derzhkomstat, in the first nine months of 2005 commodity exports grew by 6.1% yoy in dollar terms, while imports increased by 25.8% yoy. The resulted negative commodity trade balances reached USD 748 m.

Fiscal policy: The fiscal deficit for 2005 was increased to 2.2% of GDP

In November the Verkhovna Rada has approved amendments to Law on the State Budget 2005. Expenditure plan of central general fund was increased by UAH 4.1 bn or 4.2% (to UAH 83.5 bn). As a result, fiscal deficit for 2005 was increased to UAH 9.5 bn and reached 2.2% of GDP. Additional expenditures are to be financed at the expense of two major sources: current overexecution of revenues (UAH 2.4 bn) and some of receipts from re-sale of "Kryvorizhstal" (UAH 1.7 bn). These funds will be directed for financing the deficit of the Pension Fund, targeted transfers to local budgets (financing investments and wage increase), and financial interventions in agriculture. The increase in central fiscal expenditures intends to reduce risks of wage and pension arrears and release pressure on local budgets. Previously, lack of resources at local level limited fulfillment of other local programs, e.g. renewal of deteriorated local infrastructure.

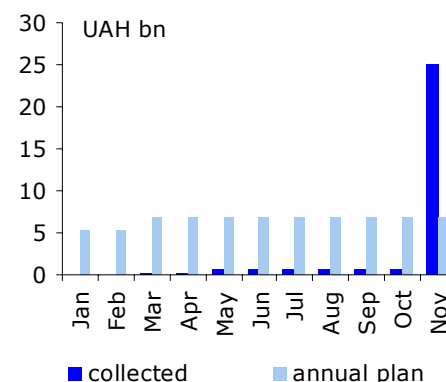
Budgeting process 2006 is already out of the schedule, as Budget Law 2006 was not approved by December 1 as required by the Budget Code. In November the Cabinet of Ministers has submitted

Investment in Fixed Capital



Source: Derzhkomstat

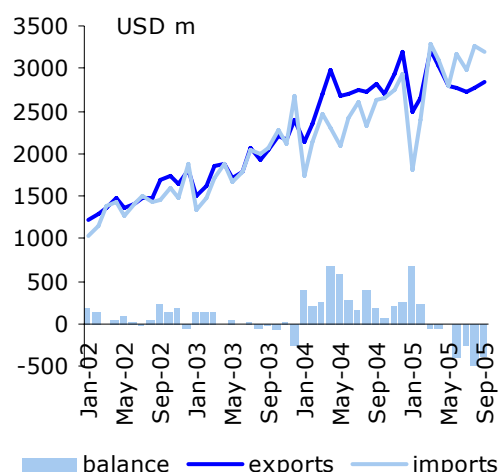
Privatization Revenues in 2005*



Source: State Treasury

* only general fund of the budget

Merchandise Trade



Source: Derzhkomstat

the revised Draft Budget Law 2006 to Parliament for the second reading. In revised draft expenditures were expanded by UAH 9 bn. The deficit rose from 1.9% of GDP to 2.5% of GDP. The government still relies on optimistic forecast of GDP growth (7%). The prognosis of major tax revenues was further increased. The Draft Budget Law foresees additional financing of infrastructure investments, support of selected sectors, and creation of stabilization fund.

Between January and October central fiscal revenues were executed at 105% of plan thanks to higher than projected revenues from enterprise profit tax and VAT. Fiscal expenditures were 6% below the target. Thus, fiscal surplus has reached 0.6% of GDP or UAH 2 bn.

Social Sector: Central government transferred additional UAH 2.8 bn to finance deficit of Pension Fund

Between January and October the Pension Fund has received UAH 50.3 bn of revenues. Own revenues of the Pension Fund accounted for 66.6% of total revenues and were by UAH 8.4 bn higher than in the same period of the previous year. Rise in revenues is attributed to growing wages in the economy. During the same period the Pension Fund received a UAH 15.6 bn fiscal transfer, from which UAH 11.4 bn was directed for deficit financing. Regardless the increase in pension duty paid from services on cellular communication and September increase in the minimum wage, the Pension Fund faces continuous deficit. Therefore, while amending the State Budget Law 2005 there was foreseen additional fiscal transfer to the Fund at the level of UAH 2.8 bn. The high deficit of the Pension Fund makes impossible continuation of the pension reform, in particular, the introduction of the second pillar of pension insurance.

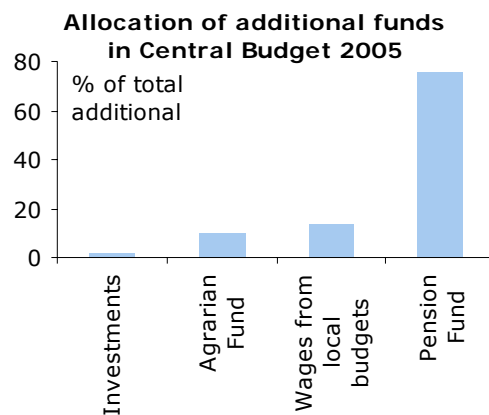
Monetary policy: CPI decelerated to 12.4% yoy

In October growth rate of consumer price index (CPI) decelerated to 12.4% yoy from 13.9% yoy in September, mostly due to changes in external conditions. In particular, domestic meat prices reduced slightly in October due to lower demand on chicken-meat resulting from intensified bird-flu fears. Gasoline prices started to go down as well, following the reduction in world oil prices. Despite these downward trends, the end-year inflation rate is likely to be at the two-digit range, as prices on some important food products, e.g. dairy products, and tariffs on services are expected to keep rising.

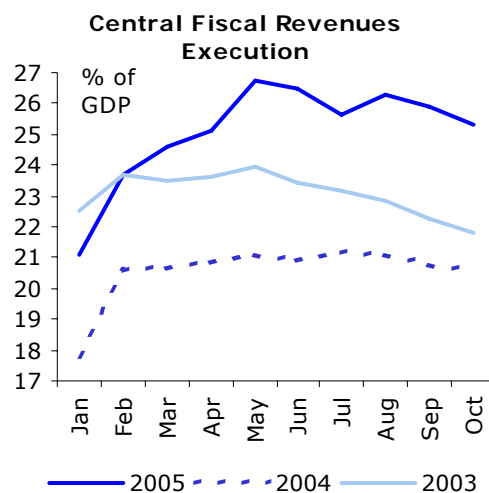
Growth rate of money supply posted 38.1% yoy in October, compared to 31.3% yoy a month before. The acceleration of annualized growth rate does not, however, indicate significant monetary expansion and is explained by low base effect of last year, when a withdrawal of deposits from the banking system took place. Taking into account this base effect as well as substantial conversion of foreign exchange received from re-sale of "Kryvorizhstal", it is expected that growth of monetary aggregates will keep accelerating and by the year-end reach the NBU's projections of monetary base and money supply (50-55% yoy and 48-53% yoy respectively).

Financial markets: The NBU tightens the requirements for inside lending by commercial banks

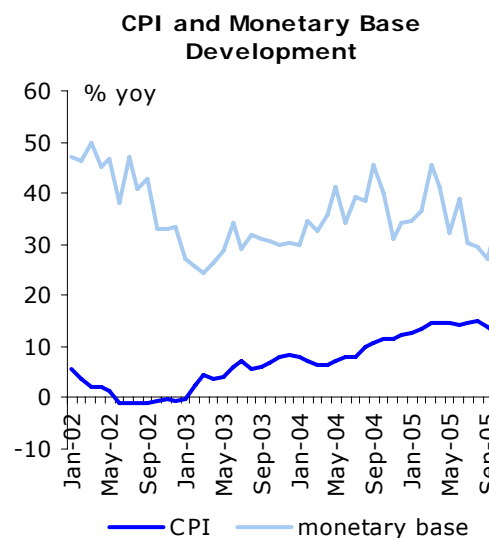
In November the NBU announced new requirements for inside lending by commercial banks. New requirements set lower limits on maximum value of loans issued to related parties (associated with bank shareholders or management). They will come into force in 2006. For defining the limits the ratio of inside loans to statutory capital will be used instead of regulatory one, which is used now and is typically lower. Also, maximum ratio of total liabilities to insiders will be reduced from 40% to 30% of statutory capital. Such measures aim at enhancing safety and stability of the banking sector in Ukraine. In particular, it is expected that they will prevent "washout" of banks' funds by related parties. However, the effectiveness of such measures may be undermined by lack of banking sector ownership transparency, which remains to be one of the challenges for adequate banking supervision.



Source: November amendments to the State Budget Law 2005



Source: State Treasury



Source: Derzhkomstat, NBU



Economic Trends		Q4 04	Q1 05	Q2 05	Q3 05	May	Jun	Jul	Aug	Sep	Oct
GDP growth (real)	% yoy	8.5	5.0	3.2	...	3.6	1.1	2.4	-1.6	3.0	2.2
GDP growth (real)	% yoy cum.	12.1	5.0	4.0	...	4.7*	4.0*	3.7*	2.8*	2.8*	2.8*
Industrial production (real)	% yoy cum.	12.5	7.1	5.0	3.2	6.2	5.0	3.9	3.5	3.2	3.1
Agricultural production (real)	% yoy cum.	19.4	3.9	6.4	3.4	4.8	6.4	6.9	2.2	3.4	1.4
CPI	% yoy eop	12.3	14.7	14.4	13.9	14.6	14.4	14.8	14.9	13.9	12.4
PPI	% yoy eop	24.1	22.0	17.7	14.7	20.5	17.7	15.7	14.7	14.7	12.9
Exports (USD)***	% yoy cum.	37.2	15.8	10.3	...	10.6"	9.2"	7.6"	6.8"	6.1"	...
Imports (USD)***	% yoy cum.	26.0	17.9	21.9	...	24.9"	26.0"	24.3"	26.4"	25.8"	...
Merchandise trade balance	USD bn cum.	3.74	1.05	0.82	...	0.79"	0.38"	0.12"	-0.37"	-0.75"	...
Current account	USD bn cum.	6.80	1.70	2.29	...	x	x	x	x	x	x
Current account	% GDP, cum.	10.4	11.4	6.8	...	x	x	x	x	x	x
Gross international reserves	USD bn eop	9.52	11.95	13.07	14.26	13.19	13.07	13.63	14.45	14.26	14.89
Monetary Base	% yoy eop	34.1	45.5	38.7	27.2	32.4	38.7	30.2	29.6	27.2	34.7
Lending rate on UAH credits **	% pa, aop	17.9'	17.0	15.4	15.4	15.9	15.4	15.2	15.2	15.4	16.1
Exchange rate (official)	USD aop	5.31	5.30	5.10	5.05	5.05	5.05	5.05	5.05	5.05	5.05
Exchange rate (official)	EUR aop	6.88	6.95	6.43	6.19	6.43	6.15	6.09	6.21	6.19	6.07

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 ^c
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