



# Monthly Economic Monitor Ukraine

- In December the EU granted market economy status to Ukraine.
- Between January and November real GDP grew by 2.2% yoy, further decelerating compared with previous periods.
- The National Electricity Regulation Commission increased electricity and gas tariffs for households.
- Current account balance reached USD 2.1 bn, or 3.7% of GDP in the first nine months of 2005.
- The approved State Budget Law for 2006 foresees the central fiscal deficit for 2006 at 2.5% of GDP.
- In November foreign reserves reached USD 19.5 bn after Mittal Steel Germany paid for Kryvorizhstal.
- The state debt decreased to USD 15.9 bn as a result of redemption of inflation-indexed domestic government bonds (POVDP).

No.1 (63)  
January  
2006

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: The EU granted market economy status to Ukraine

Provision of market economy status to Ukraine was announced during December's EU-Ukraine summit in Kyiv. Later this month the announcement was followed by official decision of the European Commission. Ukrainian government was striving to receive the market economy status for a number of years, as this status would give the country an equal treatment in trade relationship with the European Union. The market economy status ensures that possible anti-dumping investigations against Ukrainian exporters to the EU will be conducted applying normal value of exports based on the prices paid or payable in Ukraine, and not in the third country, as it is required for non-market economies. Thus, it will allow better protection against charges of illegally dumping goods on the European market.

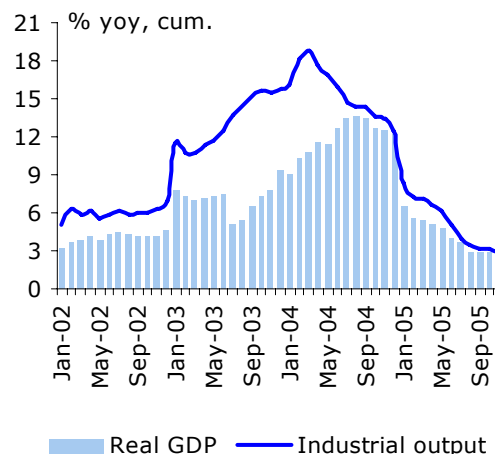
In December Ukraine and Russia continued negotiations concerning the Russian gas supply to Ukraine and the conditions of the transit of the Russian gas through the territory of Ukraine in 2006. The parties reported lack of common vision on the price of Russian gas to be supplied to Ukraine. The gas price offer of the Gazprom was USD 230 per thousand cubic meters. At the same time, the President of Ukraine Viktor Yushchenko said Ukraine is ready to pay for gas, however, not at the price USD 230, but at the "reasonably" determined price, which, in Ukrainian view is about USD 80-85 per thousand cubic meters. The negotiations continued in the beginning of January, when the agreement was finally reached. According to the signed five-year contract the joint stock company 'RosUkrEnergo' is defined as intermediary between Gazprom and Naftogaz and, thus, becomes the supplier of natural gas to Ukraine. For the first half of 2006 the gas price is set at USD 95 per thousand cubic meters. The transit price was set at USD 1.6 per thousand cubic meters per 100 km for 2006-2010.

## Real economy: Real GDP growth decelerated to 2.2% yoy in first eleven months of 2005

According to Derzhkomstat, between January and November real GDP grew by 2.2% yoy, further decelerating as compared with previous period figure. The additional slowdown is associated with slow growth of value added in manufacturing industry and agriculture, as well as continued reduction of value added in construction and trade.

Industrial output increased by 2.9% yoy in the first eleven months of the year despite two-digit growth rates in food and chemical industries. The output dropped in metallurgy and in production of coke and petroleum processing products, and significantly slowed in machinery, textile and leather industries. While decline of metal

GDP and Industrial Output



Source: Derzhkomstat

Institute for Economic Research  
and Policy Consulting  
Reytarska 8/5-A, 01034 Kyiv  
Tel. (+38044) 278-6342  
Fax (+38044) 278-6336  
E-mail: institute@ier.kiev.ua  
<http://www.ier.kiev.ua>

production is attributed to changed world market conditions, lower textile and leather output is likely due to increased competitive pressure as import barriers for selected textile products and especially shoes were significantly reduced. Depressed investment activity in the country and reduced external demand caused a deceleration in machinery.

### Sectoral trends: The tariffs for electricity and gas were increased for 2006

**Energy.** The National Electricity Regulation Commission launched phased increase in gas and electricity tariffs for population, intended to set tariffs at cost-covering level. In 2006 tariffs for electricity will rise by approximately 20% and for gas by 25%. In particular, in the first quarter of 2006 electricity will cost UAH 0.186 per kilowatt (including VAT) for urban household and UAH 0.174 per kilowatt for rural ones. The gas will cost UAH 220 or UAH 240 per thousand cubic meters depending on the presence of the gas meter. This is the first revision of electricity and gas tariffs since 1999. This decision will reduce cross-subsidization in sectors and reflects progress in structural reforms.

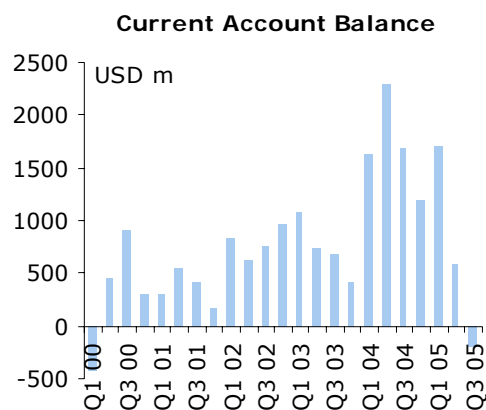
**Privatisation.** The State Budget Law for 2006 foresees privatization receipts at UAH 2 bn. Rather low as compared to 2005 plan does not comply with declared intentions of the President and government to proceed with large-scale privatization of metallurgical, mining and telecommunication enterprises. The termination of the large-scale privatization bears the risks of accumulation of inefficient state property, hampering the process of market transformations in Ukraine.

### External sector: Current account balance reached USD 2.1 bn in the first nine months of 2005

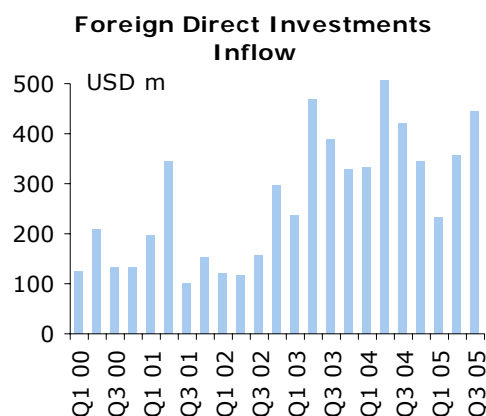
According to the NBU, in the first nine months of 2005 current account balance reached USD 2.1 bn, or 3.7% of GDP. It is nearly three times lower than in the same period of the previous year. The most of deceleration is observed in commodity exports growth rate (5.9% yoy in dollar terms in 2005 compared to 45.1% in 2004) that resulted in negative merchandise balance for the second quarter in a row. Major reasons for exports slowing down are real appreciation of national currency, increased external competition, as well as protectionism of Ukraine's Government, in particular establishment of quotas on exports of raw oil and petroleum processing products. It is expected that despite negative merchandise trade balance, the current account balance will remain positive in 2005 thanks to stable positive balance of services trade and significant current transfers inflow.

Between January and September Ukraine attracted USD 1.3 bn of foreign direct investments (FDI), somewhat less than in the same period of 2004. However, successful re-sale of metallurgical enterprise Kryvorizhstal to foreign investor Mittal Steel Germany brought additional USD 4.8 bn of FDI in the last quarter of 2005. Thus, it is expected that 2005 FDI inflow in Ukraine will reach historical maximum.

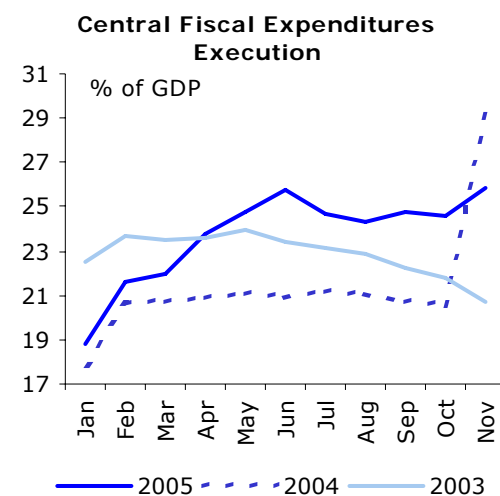
According to the Derzhkomstat, in the first ten months of 2005 commodity exports grew by 6.3% yoy in dollar terms, while imports increased by considerably higher 25.3% yoy. As a result, commodity trade balance remained negative at USD 1.0 bn. The most of deceleration is observed in exports to Europe and America, while exports to the CIS and Asia retain relatively high growth rates. The improved access to the EU and USA markets due to recent softening of trade barriers is expected to stimulate trade in 2006. The softening include provision of market economy status by the EU and elimination of trade sanctions imposed by the USA to compensate for damages incurred due to inadequate intellectual property rights protection in Ukraine.



Source: NBU



Source: NBU



Source: State Treasury

## Fiscal policy: The central fiscal deficit for 2006 is planned at 2.5% of GDP

On December 20 the Parliament has approved the Law on the State Budget for 2006. The State budget 2006 replicates previous year budget. Central fiscal revenues are projected at UAH 124 bn (24% of GDP), while expenditures are foreseen at UAH 137 bn (27% of GDP). The central fiscal deficit is planned at 2.5% of GDP.

Between January and November central fiscal revenues are executed at 105%. Revenues from enterprise profit tax and value added tax were over-performed by 19% and 13% respectively. These additional revenues offset 18% under-execution of government's revenues from profits of state-owned enterprises. The central fiscal expenditures were under-executed by 5%. The resulting fiscal deficit was UAH 0.05 bn or 0.01% of GDP.

## Social Sector: Real wages grew by 24.3% yoy due to gradual minimum wage increase

In November real wages increased by 24.3% yoy mainly due to gradual growth of minimum wage, raised from UAH 262 as of January 2005 to UAH 332 since September. The average wage in November equalled to UAH 897. Wages in agriculture and fishery remained the lowest in the economy, while the highest wages were paid in financial intermediation sector. In the state administration sector the growth of real wages was the highest (48.3% yoy) reflecting the government policy using wages rise as a tool to combat corruption. The wages grew faster in sectors, where share of budget entities is higher. However, these sectors still pay wages lower than the average in the economy.

## Monetary policy: Foreign reserves reached USD 19.5 bn thanks to payment for Kryvorizhstal

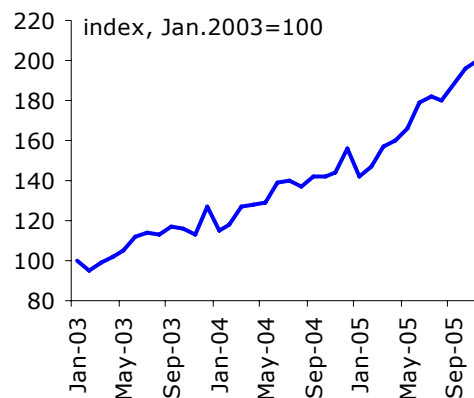
In November the development of monetary and, to larger extend, foreign exchange sectors was affected by payment of USD 4.8 bn for the metallurgical plant Kryvorizhstal by its new owner Mittal Steel Germany. The whole amount of foreign exchange was converted into hryvnia at 5.0 UAH/USD exchange rate. As a result, NBU's foreign reserves surged by 30% to USD 19.5 bn. Substantial part of the resulting UAH 24.2 bn was immediately transferred to the Unified Treasury Account within the NBU and, thus, had no effect on money supply. Yet, UAH 4.2 bn were deposited at the domestic bank account of the former owner of the plant. This repayment along with the low base effect of last year was the main reasons of sharp increase in monetary aggregates. Monetary base grew by 49.3% yoy, compared to 34.7% yoy in October, and money supply rose by 43.9% yoy, up from 38.6% yoy a month before. Apparently, due to its technical nature, this acceleration of money supply growth does not indicate monetary loosening. Quite the contrary, it is likely that banking sector experienced temporary shortage of liquidity throughout November, since the NBU has been supporting banks with refinancing loans in the gross amount of UAH 3.7 bn.

In November CPI reached 12.0% yoy, backed by continued growth of food and services prices. The reduction of meat prices for the second month in a row was counterweighted by increased prices for dairy products, eggs, vegetables and fruits. Rise of utility tariffs persisted.

## Financial markets: The state debt decreased to USD 15.9 bn

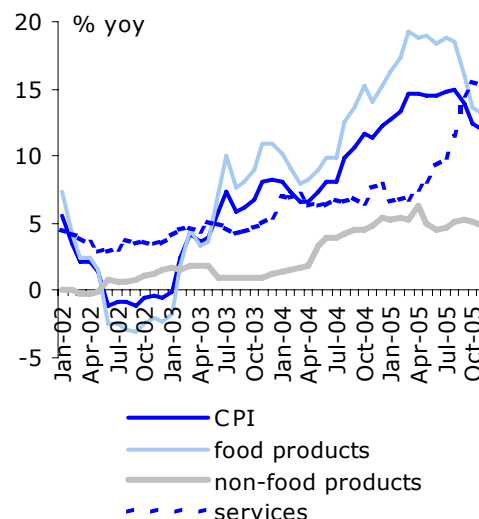
**State Debt.** The total state debt has decreased in November by USD 0.3 bn to USD 15.9 bn. This decrease is almost entirely due to pre-term redemption of USD 249 m inflation-indexed domestic government bonds (POVDP) held exclusively by the NBU. These securities have been issued in October 2000 with the purpose to restructure the government debt to the NBU accumulated in 90's. In December the Ministry of Finance continued to redeem POVDPs and announced about complete redemption of the remaining securities.

### Real Wage Index



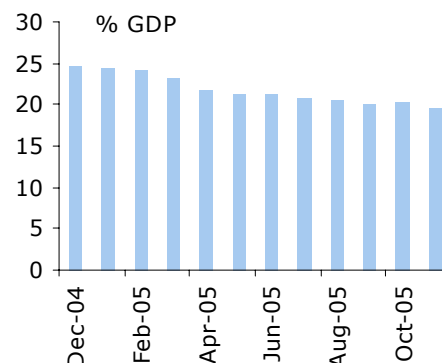
Source: Derzhkostat

### CPI and Components Development



Source: Derzhkostat

### State debt



Source: Ministry of Finance



Economic Trends		Q4 04	Q1 05	Q2 05	Q3 05	Jun	Jul	Aug	Sep	Oct	Nov
GDP growth (real)	% yoy	8.5	5.0	3.2	...	1.1	2.4	-1.6	3.0	2.2	-2.7
GDP growth (real)	% yoy cum.	12.1	5.0	4.0	...	4.0*	3.7*	2.8*	2.8*	2.8*	2.2*
Industrial production (real)	% yoy cum.	12.5	7.1	5.0	3.2	5.0	3.9	3.5	3.2	3.1	2.9
Agricultural production (real)	% yoy cum.	19.4	3.9	6.4	3.4	6.4	6.9	2.2	3.4	1.4	1.4
CPI	% yoy eop	12.3	14.7	14.4	13.9	14.4	14.8	14.9	13.9	12.4	12.0
PPI	% yoy eop	24.1	22.0	17.7	14.7	17.7	15.7	14.7	14.7	12.9	10.4
Exports (USD)***	% yoy cum.	37.2	15.8	10.3	7.7	9.2"	7.6"	6.8"	6.1"	6.3"	...
Imports (USD)***	% yoy cum.	26.0	17.9	21.9	22.6	26.0"	24.3"	26.4"	25.8"	25.3"	...
Merchandise trade balance	USD bn cum.	3.74	1.05	0.82	-1.02	0.38"	0.12"	-0.37"	-0.75"	-1.02"	...
Current account	USD bn cum.	6.80	1.70	2.29	2.09	x	x	x	x	x	x
Current account	% GDP, cum.	10.4	11.4	6.8	3.7	x	x	x	x	x	x
Gross international reserves	USD bn eop	9.52	11.95	13.07	14.26	13.07	13.63	14.45	14.26	14.89	19.47
Monetary Base	% yoy eop	34.1	45.5	38.7	27.2	38.7	30.2	29.6	27.2	34.7	49.3
Lending rate on UAH credits **	% pa, aop	17.9'	17.0	15.4	15.4	15.4	15.2	15.2	15.4	16.1	16.2
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	6.15	6.09	6.21	6.19	6.07	5.96

SOURCES: Derzhkomstat, Ministry of Finance, NBU, IFS, own calculations

" 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 <sup>e</sup>
Nominal GDP	USD bn	50.2	41.9	31.6	31.2	37.8	42.6	49.5	65.1 <sup>e</sup>
GDP growth (real)	% yoy	-3.0	-1.9	-0.2	5.9	9.2	5.2	9.4	12.1 <sup>e</sup>
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 <sup>o</sup>	1.2 <sup>oo</sup>	1.4	3.1	2.9	6.8
Current account	% GDP	-2.7	-3.1	2.9 <sup>o</sup>	3.8 <sup>oo</sup>	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 <sup>'''</sup>	% 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

<sup>'''</sup> "Minus" denotes a consolidated fiscal deficit

<sup>o</sup> 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

<sup>oo</sup> 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.

<sup>e</sup> Preliminary estimate of the Derzhkomstat

#### Notes:

<b>avg</b>	average	<b>ytd</b>	year-to-date
<b>cum.</b>	cumulative	<b>p.a.</b>	per annum
<b>mom</b>	month on month change	<b>eop</b>	end of the period
<b>qoq</b>	quarter on quarter change	<b>aop</b>	average of the period
<b>yoy</b>	year on year change	<b>gs</b>	goods and services