



# Monthly Economic Monitor Ukraine

- Based on the critique of the gas conflict with Russia the Parliament dismissed the Cabinet of Ministers.
- In 2005 real GDP grew by modest 2.4%.
- Gas price for Ukrainian industrial consumers went up to approximately USD 100 per thousand cubic meters.
- The USA restored Generalized System of Preferences (GSP) benefits for Ukraine that were suspended in August 2001.
- For the year 2005, the central fiscal deficit reached UAH 7.9 bn that is below 2% of GDP.
- In 2005 Pension Fund deficit amounted UAH 16.3 bn (4% of GDP).
- The consumer prices increased by 10.3% yoy in 2005.
- In 2005 commercial banks earned profits at UAH 2.4 bn, which is 90% higher than in 2004.

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Population: 47 m  
Industry/GDP: 27%  
Agriculture/GDP: 10%  
Investment/GDP: 19%  
Exports to: Russia 18%, EU 29%  
Imports from: Russia 40%, EU 32%

## Politics: The Parliament dismissed the Cabinet of Ministers

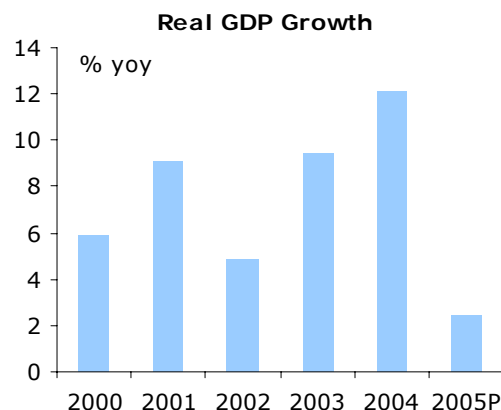
Based on the critique of the gas conflict with Russia as well as implicit intentions of some political circles to weaken pro-presidential forces, the Parliament voted for resignation of the Cabinet of Ministers. 250 out of 405 present deputies supported this decision, including representatives of Communist party, Party of Regions, Agrarian Party, and the Block of Yulia Tymoshenko. According to changes to the Constitution that came into force in January 2006, the Parliament received the right to resign the Cabinet, but does not yet possess the right to appoint a new one. The President and the Prime Minister announced that they do not perceive the Parliament's decision as constitutional. In order to resolve the constitutional crisis the President sought justice in the Constitutional Court of Ukraine; however, this court is not complete with members due to the Parliament's unwillingness to swear in the judges of the Constitutional Court. Thus, de facto the acting Cabinet of Ministers headed by Yuriy Yekhanurov is expected to operate in its present capacity until the parliamentary elections.

President of Ukraine Viktor Yushchenko recalled his signature under the memorandum of cooperation with the opposition, motivating it by other side's violation of the principle of common actions to support political stability in the country. Representatives of pro-presidential Nasha Ukraina party even called for the dissolution of the Parliament and introduction of direct presidential rule in the country. The vote of no confidence was the first trial of the Parliament of its increased powers as constitutional reform that transforms Ukraine from a presidential to a parliamentary republic comes into effect. Viktor Yushchenko said he is likely to put the question of constitutional reform on the national referendum.

## Real economy: Real GDP grew by 2.4% in 2005

According to Derzhkomstat preliminary information, in 2005 real GDP grew by 2.4%. It is the lowest growth figure since the beginning of economic recovery in 2000. On production side, the deceleration of growth is linked to significant slowdown in agriculture (0.8%) and manufacturing industries (3.0%), as well as to reduction of value added in construction (-6.6%) and trade (-8.3%). While lower growth figure in agriculture is explained by high statistical base effect and moderate grain harvest, the deceleration in manufacturing is largely attributed to drop in metallurgy. Reduction in construction mirrors the low investment activity in the country.

On demand side, according to nine-month data, final households' consumptions leads the growth (17.0% yoy). At the same time, it stimulates imports. For example, the demand for housing appliances, such as electric equipment, increased by 36.6% yoy being stimulated by liberalization of imports. The low figure of GDP growth was related



Source: Derzhkomstat  
P - preliminary estimate

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to deteriorating external demand that led to reduction in real exports of goods and services (-10.5% yoy) and depressed investment activity that was reflected in decline of real gross fixed capital accumulation (-1.0% yoy).

Industrial output in 2005 increased by moderate 3.1% compared to 12.5% growth in the previous year. The stable growth of food and chemical industries was counterweighted by drop in metal production and deceleration of machine building.

**Sectoral trends: Gas price for industrial consumers increased**

**Energy.** According to Naftogaz in January gas price for Ukrainian industrial consumers went up to nearly USD 100 per thousand cubic meters (including VAT) in response to the increase in imported gas price. However, even this price covers only nearly 90% of costs of gas from Russia and Turkmenistan. The cost of gas used by heating enterprises is even farther from cost covering levels. Thus, further gas price growth is expected.

**Privatisation.** In 2006 privatisation revenues are planned at UAH 2.12 bn, which is rather moderate compared to historically highest revenues in 2005 at more than UAH 20 bn. Privatisation plans for 2006 still remain unclear. In January the President signed the Law that prohibits privatisation of big machinery plant "Turboatom" and chemical plant Odessa Portside Factory in 2006. On the one hand, this decision seems correct, especially taking into account political and economic instability on the eve of parliamentary elections in March. On the other, the suspension of privatisation and absence of new privatisation program undermines consistency and efficiency of property transformation process.

**Agriculture.** From January 20, 2006 Russia banned imports of Ukrainian livestock products (including dairy products) allegedly due to numerous violations of Russian veterinary legislation. Since Russia is an important export market for Ukraine consuming 63% of the total dairy export, domestic producers would suffer considerable losses predominantly through lower procurement prices. The ban would lead domestic oversupply of livestock products and a decrease in domestic prices.

**External sector: The USA restores Generalized System of Preferences benefits for Ukraine**

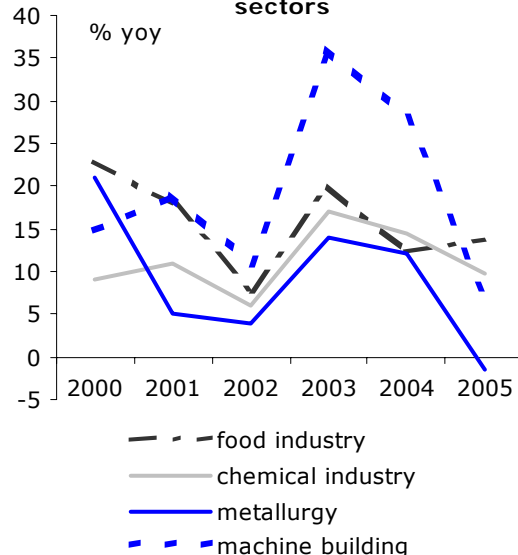
In January the USA lowered Ukrainian designation from "priority foreign country" to "priority watch list" under trade legislation on enforcement and protection of intellectual property rights. As a result, the USA restores Generalized System of Preferences (GSP) benefits for Ukraine that were suspended in August 2001. The revision of Ukraine's status became possible after the Verkhovna Rada passed the law introducing criminal responsibility for production of pirated CDs in July 2005. The GSP provides preferential duty-free treatment for 3,400 products, including such important for Ukraine export products as iron and steel articles, electrical and railway products, and casein.

According to the Derzhkomstat, between January and November commodity exports increased by 5.6% yoy in dollar terms, while imports grew by 24.6% yoy. As a result, the negative merchandise trade balance reached USD 1.3 bn compared to a positive USD 3.4 bn balance in the same period of 2004. Liberalization of imports regime, real appreciation of hryvnia, growth of oil prices and reduced external demand are among the reasons for negative trade balance.

**Fiscal policy: Central fiscal deficit was under 2% of GDP in 2005**

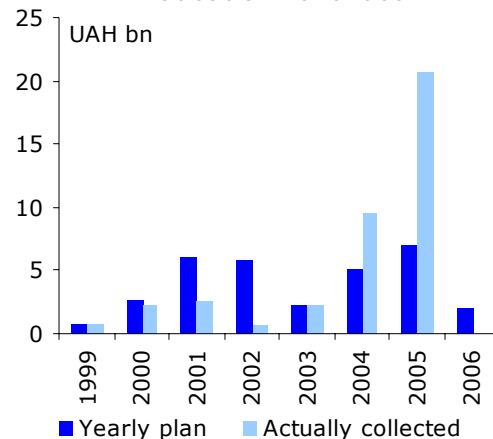
In 2005 central fiscal revenues were executed at 99%. In particular, the revision of plan allowed over-execution of revenues from enterprise profit tax and profits of state-owned enterprises by 4% and 7% respectively. Despite the decrease in overdue VAT refund arrears to UAH 0.6 bn, the VAT revenues was over-executed by 1%.

**Growth of output in key industrial sectors**



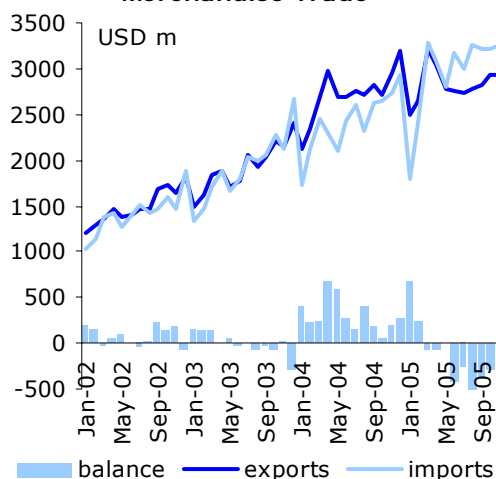
Source: Derzhkomstat

**Privatisation Revenues**



Source: State Treasury

**Merchandise Trade**



Source: Derzhkomstat

At the same time, the state under-received rent payments and NBU profits, execution levels of which were 89% and 79% respectively. The central fiscal expenditures remained 4% below the annual plan. The central and consolidated fiscal deficits were respectively UAH 7.9 and 7.7 bn (below 2% of GDP) in 2005.

### Social Sector: Pension Fund deficit was UAH 16.3 bn in 2005

According to the Pension Fund, in 2005 total Fund's expenditures on pension payments doubled as compared to 2004 and exceeded UAH 64.0 bn accounting for almost 16.0% of GDP. The total central fiscal transfer to the Pension Fund reached UAH 22.7 bn, from which UAH 16.3 bn (near 4% of GDP) were directed to financing the Fund's deficit. It is 2.7 times higher than in the State Budget 2005 approved in December 2004. For 2006, the central fiscal transfer for financing Fund's deficit is planned at UAH 7.3 bn. Although planned deficit is lower than in 2005, it might increase during the year if the government fails to conduct policies aimed at improving business climate, and thus, encouraging wage growth in economy.

### Monetary policy: In 2005 the consumer prices increased by 10.3%

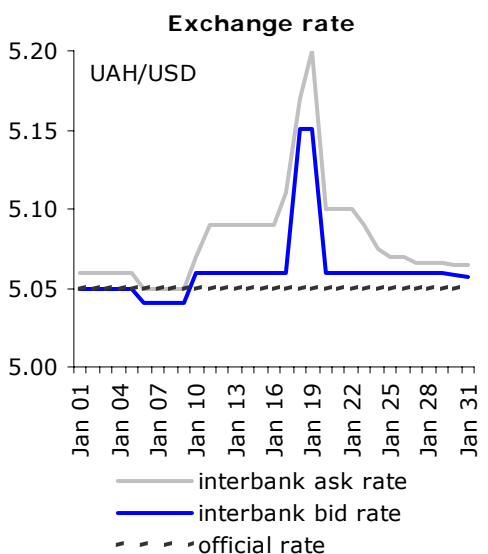
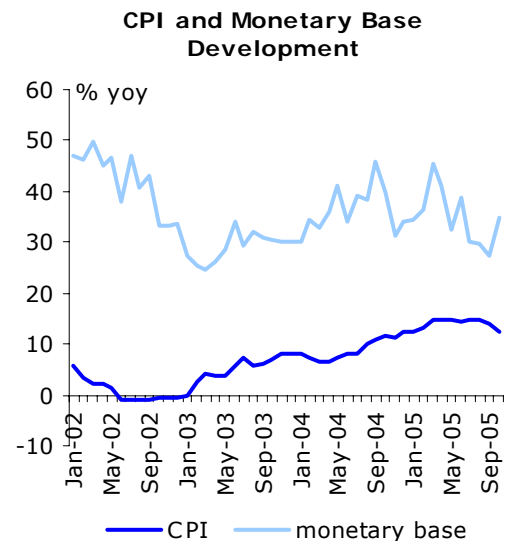
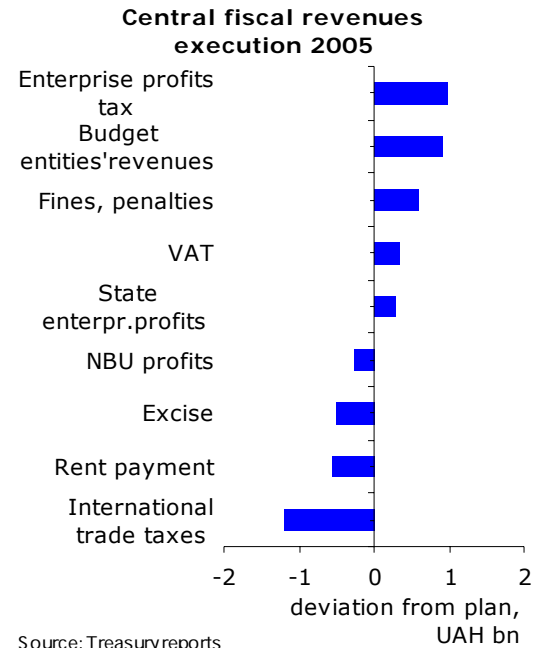
In 2005 the consumer prices increased by 10.3% yoy, thus remaining above ten percent level the second year in a row. The key factor behind consumer price growth was the increased households' demand for food products not supported by adequate supply. The demand was stimulated by expansionary social and wage policies of the government, while supply was constrained by existing domestic production capacities and high protection of agricultural market against imports. Although in the second half of 2005 the food price growth slowed contributing to decelerating path of consumer inflation, an increase in service sector tariffs, in particular, transportation, electricity and utility tariffs, has become an additional inflation-generating factor.

Growth rates of monetary aggregates in 2005 replicated step upward trends of previous years, once again confirming that the inflation had non-monetary character. Monetary base increased by 53.9%, while money supply by 54.8%. The increase in money supply is to a large extent explained by reinstatement of bank deposits after 2004 crisis and UAH 4.2 bn payment for metallurgical plant "Kryvorizhstal" to its previous owner.

### Financial markets: Profits of commercial banks increased by 90% in 2005

**Banking sector.** According to the NBU, commercial banks in 2005 earned profits at UAH 2.4 bn, which is 90% higher than in 2004. In 2005 the banking sector also performed better in the terms of efficiency: the return on capital increased from 8.43% to 10.28%, while the return on assets changed only slightly from 1.07% to 1.31%. As before, interest earnings continued to be the main source of revenues in the banking sector providing nearly 70% of total revenues. The distinctive feature in last year's development was rapidly increasing households crediting. The share of credits granted to households in the total volume of credits grew to above 21% from 15% at the end of 2004. The upward trend signals that the role of commercial banks in stimulating the private consumption of durable goods is becoming more important.

**Exchange rate.** In mid-January the political instability associated with 'no confidence' vote for the Cabinet of Ministers and uncertainty resulted from increased gas price led to a temporary hike in the price of hryvnia from 5.05 UAH/USD to 5.15 UAH/USD bid rate at interbank market. However, the NBU interventions reduced the rate and allowed preserving the official rate at 5.05 UAH/USD. The NBU spent USD 940 m of official reserves during the month, thus, reducing the reserves to USD 18.6 bn.





Economic Trends		Q4 04	Q1 05	Q2 05	Q3 05	Q4 05	Aug	Sep	Oct	Nov	Dec
GDP growth (real)	% yoy	8.5	5.0	3.2	1.2	...	-1.6	3.0	2.2	-2.7	...
GDP growth (real)	% yoy cum.	12.1	5.0	4.0	2.8	...	2.8*	2.8*	2.8*	2.2*	2.4*
Industrial production (real)	% yoy cum.	12.5	7.1	5.0	3.2	3.1	3.5	3.2	3.1	2.9	3.1
Agricultural production (real)	% yoy cum.	19.4	3.9	6.4	3.4	0.0	2.2	3.4	1.4	1.4	0.0
CPI	% yoy eop	12.3	14.7	14.4	13.9	10.3	14.9	13.9	12.4	12.0	10.3
PPI	% yoy eop	24.1	22.0	17.7	14.7	9.6	14.7	14.7	12.9	10.4	9.6
Exports (USD)***	% yoy cum.	37.2	15.8	10.3	7.7	...	6.8"	6.1"	6.3"	5.6"	...
Imports (USD)***	% yoy cum.	26.0	17.9	21.9	22.6	...	26.4"	25.8"	25.3"	24.6"	...
Merchandise trade balance	USD bn cum.	3.74	1.05	0.82	-1.02	...	-0.37"	-0.75"	-1.02"	-1.34"	...
Current account	USD bn cum.	6.80	1.70	2.29	2.09	...	x	x	x	x	x
Current account	% GDP, cum.	10.4	11.4	6.8	3.7	...	x	x	x	x	x
Gross international reserves	USD bn eop	9.52	11.95	13.07	14.26	19.39	14.45	14.26	14.89	19.47	19.39
Monetary Base	% yoy eop	34.1	45.5	38.7	27.2	53.9	29.6	27.2	34.7	49.3	53.9
Lending rate on UAH credits **	% pa, aop	17.9'	17.0	15.4	15.4	16.4	15.2	15.4	16.1	16.2	16.4
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	6.00	6.21	6.19	6.07	5.96	5.99

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		1998	1999	2000	2001	2002	2003	2004	2005
Nominal GDP	UAH bn	102.6	130.4	170.1	204.2	225.8	264.2	345.9	...
Nominal GDP	USD bn	41.9	31.6	31.2	37.8	42.6	49.5	65.1	...
GDP growth (real)	% yoy	-1.9	-0.2	5.9	9.2	5.2	9.4	12.1	2.4 <sup>e</sup>
Industrial production	% yoy	-1.0	4.0	13.2	14.2	7.0	15.8	12.5	3.1
Agricultural production	% yoy	-9.6	-6.9	9.8	10.2	1.2	-11.0	19.1	0.0
CPI	% yoy aop	10.6	22.7	28.2	12.0	0.8	5.2	9.0	13.5
CPI	% yoy eop	20.0	19.2	25.8	6.1	-0.6	8.2	12.3	10.3
PPI	% yoy aop	13.2	31.5	20.9	8.6	3.1	7.8	20.4	16.8
PPI	% yoy eop	35.4	15.7	20.8	0.9	5.7	11.2	24.1	9.6
Exports (gs, USD)	% yoy	-13.4	-7.9	17.9	9.5	10.7	24.0	37.2	...
Imports (gs, USD)	% yoy	-14.0	-19.1	18.9	14.1	4.9	28.7	26.0	...
Current account	USD bn	-1.3	0.9 <sup>o</sup>	1.2 <sup>oo</sup>	1.4	3.1	2.9	6.8	...
Current account	% GDP	-3.1	2.9 <sup>o</sup>	3.8 <sup>oo</sup>	3.7	7.6	5.9	10.4	...
FDI (net)	USD bn	0.7	0.5	0.6	0.8	0.7	1.4	1.7	...
International reserves	USD bn	0.79	1.09	1.48	3.09	4.42	6.94	9.52	19.39
Fiscal balance'''	% GDP	-2.7	-2.1	-0.7	-1.9	0.8	-0.2	-3.4	...
Total state debt	% GDP eop	49.4	61.4	45.2	36.3	34.3	29.5	24.7	...
External debt (total)	% GDP eop	38.4	49.9	33.0	26.0	24.6	17.3	18.6	...
Monetary base	% yoy eop	21.9	39.3	39.9	37.4	33.6	30.1	34.1	53.9
Exchange rate	USD aop	2.45	4.13	5.44	5.37	5.33	5.33	5.31	5.12
Exchange rate	USD eop	3.43	5.07	5.44	5.30	5.33	5.33	5.31	5.05
Exchange rate	EUR aop	2.77	4.39	5.03	4.81	5.03	6.02	6.62	6.40
Exchange rate	EUR eop	4.02	5.20	5.10	4.67	5.53	6.66	7.22	5.97

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

''' "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