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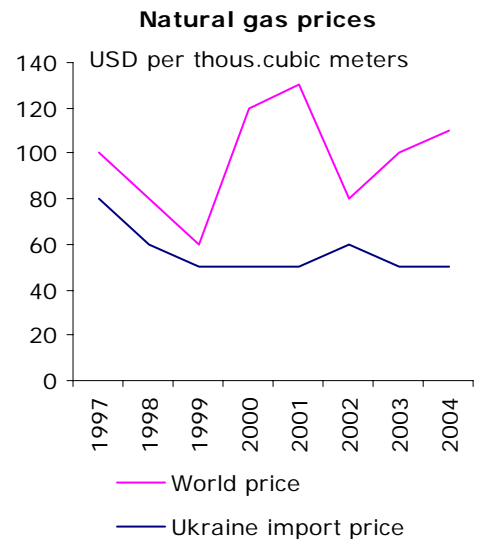
Gas dispute: temporary truce

Gas dispute between Russia and Ukraine peaked in early January, when Russia cut gas supply to Ukraine and Ukraine started to divert part of transit gas for its domestic consumption. Ukrainian authorities claimed that they were just taking their fee for transit of Russian gas according to provisions in existing contracts. After customers from Western Europe noticed shortages Russia had to resume full gas deliveries. To resolve the dispute an agreement was signed between Gazprom, Naftogaz Ukrainy and RosUkrEnergO concerning the supply of gas to Ukraine for the first half of 2006. An agreement sets the main parameters of transit and gas supply. The most notable points of the agreement include setting of the transit fee over the Ukrainian territory at USD 1.6 per 100 km per thousand cubic meters (tcm) to be paid in cash (previously USD 1.09 paid in barter gas), price of gas for Ukraine is fixed at USD 95 per tcm at the Russian-Ukrainian border. In the early February RosUkrEnergO and Naftogaz Ukrainy formed a joint-stock company, which is to sell gas to the consumers in Ukraine.

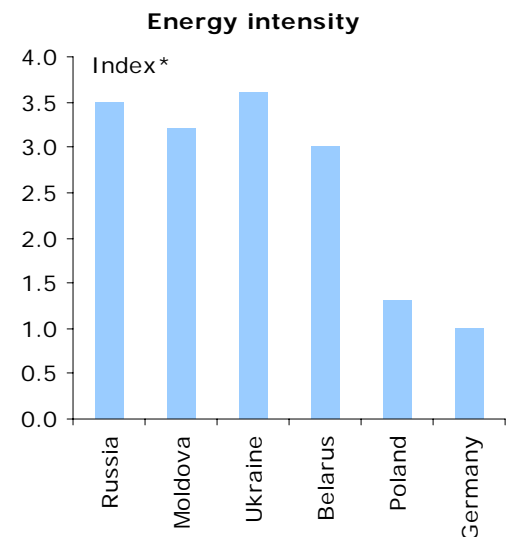
The contract signed in haste on January 4 raised many questions and should rather be treated as an intermediate solution for the gas trade between Russia and Ukraine than a permanent framework. The deal sets the price of gas at USD 95 at the Ukrainian border, but mentions that this price is achieved from mixing of Russian gas priced at USD 230 per tcm and from cheaper gas from Central Asian states as well as from proceeds from gas exports by RosUkrEnergO. The January gas deal sets the price only for the first half of 2006 and it is likely that negotiations will be renewed after the parliamentary elections in Ukraine, once the new government supported by parliamentary majority is formed. RosUkrEnergO as an intermediary between Gazprom and Naftogaz Ukrainy raised doubts on both sides as to its necessity. Gazprom, partially owning to RosUkrEnergO, loses some of its profits from transit of gas purchased by Ukraine from Turkmenistan through Russian territory as well as from exports of Russian and Central Asian gas to Ukraine. The creation of the joint-stock venture between RosUkrEnergO and Naftogaz Ukrainy means that Naftogaz will forgo some of its profit from domestic sales to the joint-stock company. Introduction of an intermediary company is likely to be a mean for diverting resources from supplier and importer possibly allowing for rent collection.

Politicians used this gas deal to accuse the current power of the "sale of national interests" and as a pretext for the vote of no confidence to the current government, while business circles are unhappy with increase in the gas price. As of now, the government abstains from significant price increases for gas either for population or for industry, which implies necessity for Naftogaz Ukrainy to increase subsidization of domestic gas consumption. The gas dispute highlighted long-ignored problems in the energy sector. Monopoly of the state over the gas market guaranteed low price in the past, but it is now apparent that the state became the scapegoat for the price increase, which under market conditions would be transferred from the market to consumers. Low prices for gas, subsidized from the transit fees, were not stimulating the consumers to increase energy efficiency.

While the temporary truce in the gas dispute has been reached, the state should take urgent actions to prepare for further price growth and for accommodating current price shock. To secure the financial standing of the Naftogaz Ukrainy tariff setting should adhere to full cost-recovery. This requires strengthening of the National Electricity Regulation Commission as the regulator on the market. With gradual decrease of cross-subsidization schemes targeted social aid programs should be put in place to help poor pay the increased gas prices as well as not to allow accumulation of payment arrears. No state aid should be promised to the industry, but only supporting measures inducing enterprises to increase energy efficiency and, if appropriate, fuel switching.



Source: IMF, NBU, WB



Source: WB

* - GDP in PPP, Germany=1

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Quarterly Trends

National accounts **		Q3 02	Q2 03	Q3 03	Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Q1 05	Q2 05	Q3 05	Q4 05
GDP	UAH bn	64.1	60.0	75.6	77.1	64.7	79.0	100.5	100.6	82.5	95.0	120.0	...
GDP (real)	% yoy	4.3	10.0	6.8	12.1	12.7	13.7	14.0	8.5	5.0	3.2	1.2	...
Households consumption (real)	% yoy	8.9	14.4	11.2	13.6	14.6	16.8	13.1	16.2	16.4	14.6	19.4	...
State consumption (real)	% yoy	-18.8	17.8	19.2	9.0	3.3	1.0	5.0	10.1	5.2	2.2	2.3	...
Gross fixed capital formation (real)	% yoy	3.8	20.4	24.3	9.0	18.4	6.5	4.6	12.9	-2.6	-0.9	-0.1	...
Exports of goods and services (real)	% yoy	15.3	9.8	9.8	11.6	18.1	19.9	10.5	8.6	0.1	-2.5	-17.9	...
Imports of goods and services (real)	% yoy	10.4	16.2	17.4	17.7	13.8	7.3	6.7	7.8	6.6	2.1	1.7	...
Agriculture, hunting, forestry (real)*	% yoy	2.1	-13.7	-22.5	6.7	-4.4	0.9	35.7	9.9	5.9	8.5	2.2	...
Manufacturing industry (real)*	% yoy	8.0	15.4	23.0	20.1	23.9	16.3	12.5	9.4	7.8	3.2	0.2	...
Construction (real)*	% yoy	-1.2	24.8	30.9	16.9	29.9	30.6	16.4	3.9	-5.9	-9.0	-6.3	...
Trade, repair services (real)*	% yoy	8.8	15.1	22.6	29.6	23.6	35.0	2.7	13.7	-1.5	-3.2	-6.2	...
Transport (real)*	% yoy	7.9	11.5	15.9	11.7	10.1	8.0	12.3	10.5	7.3	6.8	4.7	...
Balance of payments													
Current account balance	USD bn	0.8	0.7	0.7	0.4	1.6	2.3	1.7	1.2	1.7	0.6	-0.2	...
Current account balance	% of GDP	6.4	7.0	5.0	3.0	13.5	15.5	8.8	6.2	10.8	3.2	-0.8	...
Trade balance in goods	USD m	155	-42	-155	-381	933	1552	774	482	1051	-228	-1017	...
Trade balance in services	USD m	247	399	362	409	332	153	377	270	257	355	321	...
Current transfers	USD m	517	526	574	584	475	758	720	623	624	692	741	...
Direct investment (FDI)	USD m	156	454	390	329	334	614	422	345	231	355	445	...
Portfolio investments	USD m	-592	640	-444	-293	60	-406	781	-511	-114	-86	-1253	...
Gross international reserves	USD bn	4.1	6.2	6.7	6.9	7.9	9.6	12.1	9.5	12.0	13.1	14.3	...
Fiscal indicators													
Consolidated fiscal revenues	% of GDP	28.2	31.7	30.1	28.6	27.2	26.9	26.3	25.9	32.1	35.1	31.5	31.0
Personal income tax	% of GDP	4.9	5.7	5.3	5.1	4.4	4.1	3.8	3.8	4.3	4.4	3.9	4.2
Enterprise profits tax	% of GDP	4.1	5.1	4.8	5.0	3.9	4.0	4.1	6.1	4.8	5.9	5.3	6.3
Value-added tax	% of GDP	6.4	6.3	5.8	4.8	6.2	5.7	5.1	4.1	8.6	9.2	7.9	7.3
Excise tax	% of GDP	1.9	2.2	2.1	2.0	2.1	2.1	2.0	1.8	2.0	2.0	2.0	1.7
Consolidated fiscal expenditures	% of GDP	26.4	29.2	27.9	28.8	25.3	26.5	26.8	35.2	28.3	36.4	28.1	41.7
Current expenditures	% of GDP	na	26.3	24.2	24.3	22.4	22.7	21.7	27.2	26.5	33.6	24.0	34.2
Capital expenditures	% of GDP	na	3.0	3.7	4.4	2.9	3.8	5.1	8.0	1.8	2.7	4.1	7.5
Consolidated fiscal balance	% of GDP	1.7	2.5	2.2	-0.2	1.9	0.4	-0.5	-9.3	3.7	1.0	-5.0	6.2
Privatisation receipts	% of GDP	0.3	1.0	1.0	0.8	1.5	3.7	3.5	1.0	0.2	0.6	0.6	16.0
Labour market													
Average wage (real)	% yoy	21.2	19.1	19.9	14.9	19.9	18.6	14.7	15.4	15.0	19.0	19.6	...
Household income (real)	% yoy	100.8	8.6	10.0	8.7	11.7	16.3	11.3	16.6	24.0	28.0	19.4	...
Unemployment rate (ILO methodology)	%	9.2	8.8	9.2	9.0	9.3	8.3	8.1	8.7	8.7	7.0	5.2	...
Banking system													
Monetary aggregate M0	% yoy cum	46.0	37.0	30.5	25.3	29.1	25.6	37.1	27.9	28.2	39.1	31.1	42.2
Monetary aggregate M2	% yoy cum	46.5	54.6	49.9	47.6	45.4	44.8	51.5	32.3	38.9	37.4	31.3	53.9
Household deposits in national currency	% yoy cum	103.6	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	55.1	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	42.3	71.2	73.0	61.7	56.8	52.1	44.3	29.4	28.3	32.6	43.4	58.7
Com. bank credits in foreign currency	% yoy cum	37.3	48.4	57.7	60.9	63.6	56.2	43.5	32.2	33.1	36.8	47.1	66.3
Long-term com. bank credits	% yoy cum	85.8	156.4	164.0	157.9	141.7	102.7	82.7	57.1	49.5	53.0	70.1	84.6
Long-term com. bank credits	% of total	25.3	37.4	40.1	45.0	47.4	49.3	50.9	54.2	54.4	56.1	59.7	61.8
Average lending rate on national cur. credits	% p.a.	23.5	17.2	17.2	17.7	17.2	16.6	17.0	17.6	17.0	15.4	15.4	16.4
Average lending rate on foreign cur. credits	% p.a.	11.9	12.6	11.7	10.9	12.2	12.1	12.6	12.2	12.1	11.0	11.3	11.7

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