



Monthly Economic Monitor Ukraine

- The USA has granted Ukraine the market economy status.
- In January 2006 the real GDP grew by mere 0.9% yoy.
- Naftogaz Ukrainy and RosUkrEnergo created a joint venture UkrGasEnergo.
- The negative balance of commodity trade reached USD 1.85 bn in 2005.
- Slowdown of economic activity was reflected in shortfall of enterprise profit tax revenues.
- Consumer price growth slightly decelerated to 9.8% yoy in January 2006.

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Politics: The USA has granted Ukraine the market economy status

The USA, following a similar decision by the EU, has granted Ukraine the market economy status. Ukraine's bid for market economy status began in 2002, in connection with an antidumping investigation on steel wire rod under the US Trade Law. As a result of the new Ukraine's status the US Commerce Department will now use the standard market economy methodology in considering antidumping cases meaning that investigation will be conducted on the basis of Ukrainian instead of the third country prices. Six criteria were considered in determining the market or non-market status of the Ukrainian economy. Those criteria included the extent of currency convertibility, free bargaining for wage rates, foreign investment, government ownership or control of production, government control over the allocation of resources, and other appropriate factors. This decision facilitates Ukraine to conclude the WTO membership talks with the USA.

On February 28, the President of Ukraine Viktor Yushchenko met with the President of Poland Lech Kaczyński in Kyiv. Among the discussed issues was the continuation of the Odesa-Brody pipeline project. Both sides were optimistic concerning the success of the project as currently a Kazakh company is working on the oil terminal Pivdennyj to enable it to work with light oil. Also there is a USD 2 bn investment envisioned in the oil refining plant in Brody.

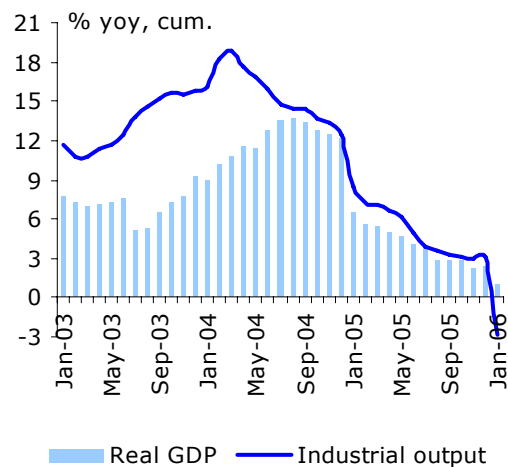
On the eve of parliamentary elections scheduled for March 26, the political parties are trying to agree upon a coalition that could allow them to form a majority in the future Parliament. According to the amendments to the Constitution that came into force in January 2006, after elections the new parliamentary majority will appoint Prime minister and form the Cabinet of Ministers. However, opinion polls show that no single party will have enough votes to form the Government alone, thus parties are forced to search for allies. In particular, in February political forces, which were the driving forces of the Orange revolution (Pora-PRP, Yulia Tymoshenko Bloc and Nasha Ukraina), have attempted to sign an agreement on creating a coalition. The attempt failed due to differences in the texts of the agreement, proposed by parties. Also, no coalition of opposition parties has been formed so far.

Real economy: In January 2006 the real GDP grew by mere 0.9% yoy

In January 2006 the economic development in Ukraine further decelerated. According to Derzhkomstat estimates, the real GDP grew by mere 0.9% yoy against the background of severe external price shock, namely the sharp increase in the price of imported gas. The low growth rate of the real GDP is explained by a significant drop in valued added in manufacturing and extractive industries, as well as persistent negative growth rates in construction. These trends were only partially counterweighted by increased value added in agriculture and transport.

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

GDP and Industrial Output



Source: Derzhkomstat

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Industrial output declined by 2.9% yoy in January 2006 compared to the 9.0% yoy rise in the same period of the previous year. The major reduction occurred in manufacturing industry (-4.6% yoy), followed by extractive industry (-1.0%). These negative trends were only partially compensated by swift growth in production and distribution of electricity, gas and water (+13.2%) provoked by the cold winter. The reduction in output in manufacturing is mainly attributed to significant drop in chemical industry and metallurgy due to increased gas prices, and continuous decline in petroleum refinement. Slower growth rates in food industry, which in part are due to a ban on exports of livestock products to Russia, were not able to offset the drop in other industry sectors.

Sectoral trends: Naftogaz Ukrainy and RosUkrEnerg created a joint venture UkrGasEnerg

Energy. Following the conclusion of gas contract, signed on January 4, Naftogaz Ukrainy and RosUkrEnerg created a joint venture UkrGasEnerg, which is to sell gas to industrial enterprises in Ukraine. The joint venture, not licensed yet to operate at the market, was formed despite the number of concerns voiced by many politicians and policy makers. Although the Antimonopoly Committee stated that creation of UkrGasEnerg should not lead to monopolisation of the market, the Cabinet of Ministers adopted a price ceiling for gas sold on the Ukrainian market at USD 110 per thousands cubic meters net of VAT and distribution costs to protect consumers from price hikes.

Privatisation. Recently, after long litigation Kyiv Appeal Court decided to return the 50%+1 asset shares of Nikopol Ferroalloy Plant to the state property, which was privatised in 2003 by a consortium "Pridneprovie", associated with the son-in-law of former president Leonid Kutchma. However, the State Property Fund (SPF) has not yet executed this decision due to problems with registration and custody of the shares. Possessing no shares, the SPF cannot start preparatory procedures for the repeated privatisation of the plant. The attempts of the parliament to prohibit the privatisation of the Nikopol Ferroalloy Plant have hitherto failed as the President vetoed the respective law. As of now, the future of the Nikopol Ferroalloy Plant remains unclear.

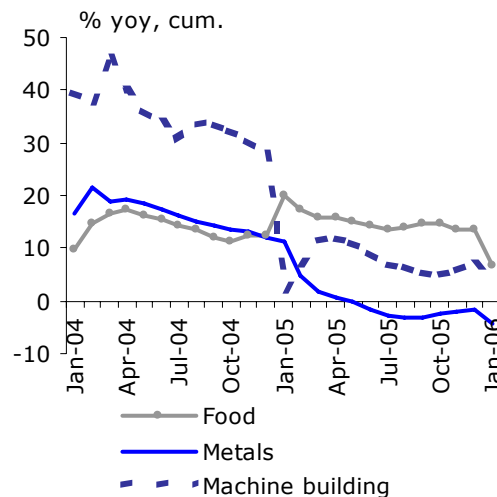
External sector: The negative balance of commodity trade reached USD 1.85 bn

According to the Derzhkomstat, in 2005 the commodity exports increased by 5.0% in dollar terms, while imports grew by 24.6%. As a result, the negative balance of commodity trade reached USD 1.85 bn. The high growth rates of exports to the CIS countries, in particularly Russia, were outweighed by drop in exports to the EU and the USA and decelerated exports to Asia. Lower exports to Europe and Asia are likely to be due to reduced demand for Ukrainian steel and establishment seasonal quotas on exports of fuel. In imports the situation is the opposite, with the highest growth of imports from the non-CIS countries. The real appreciation of hryvnia, liberalisation of import regime, administrative interventions in exports, and reduced external demand are among the reasons for relatively low growth of exports and acceleration of imports in 2005. It is expected that the negative balance of commodity trade will persist in 2006, first of all due to sharp growth of imported gas price.

Fiscal policy: Slowdown of economic activity was reflected in shortfall of enterprise profit tax revenues

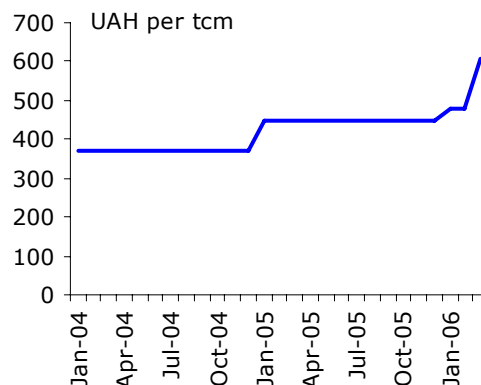
In January the enterprise profit tax (EPT) revenues was underexecuted by 38%, the shortfall that could be explained by significant slowdown of economic activity at the beginning of the year. However, higher than planned execution of other fiscal revenues, including over-execution of the VAT by 21%, offset the drop in the EPT proceeds. As a result, central fiscal revenues were 9% higher than planned. The central fiscal expenditures were 20% below the target. While social provision and financing

Growth of Output in Selected Industries



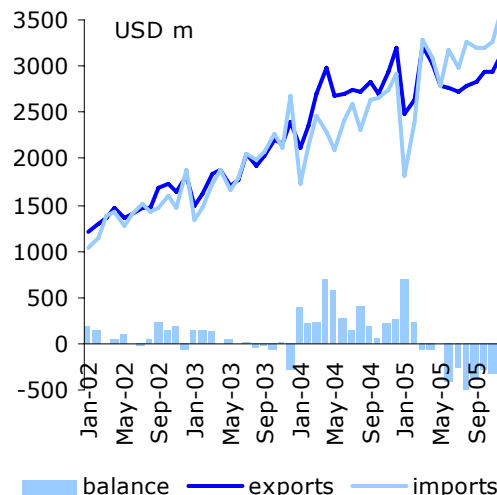
Source: Derzhkomstat

Gas prices for industry



Source: Gas Ukraine

Merchandise Trade



Source: Derzhkomstat

intergovernmental transfers was financed at 93% and 97% respectively, the health care and education expenditures were significantly underfinanced, barely reaching a half of the planned amount. Traditionally low execution rate of expenditures at the beginning of each year is explained by the technical difficulties. The central fiscal surplus was UAH 0.7 bn or 2.6% of GDP.

Demography: Ukrainian population continued shrinking

During 2005 number of Ukrainians has further reduced by almost 1% and amounted to 46.93 m as of January 1, 2006. The main reason for this reduction was negative difference between birth and death rates. In particular, in 2005 the birth rate was 9 per 1000 persons remaining at 2004 level, while death rates slightly increased to 16.6 per 1000 persons. However, the death rates of babies up to one year old decreased in 2005, which might indicate some improvement in living standards in the country. The existing structure of Ukraine's population that is heavily biased towards old people creates constant pressure on social system, demanding for urgent reforms, including pension reform.

Monetary policy: Consumer price growth decelerated to 9.8% yoy

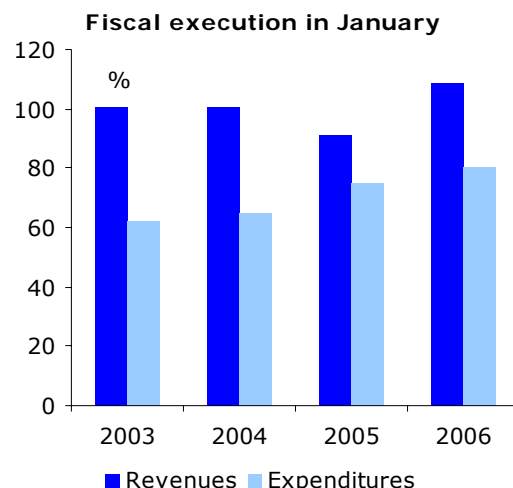
In January 2006 consumer price growth decelerated slightly to 9.8% yoy, compared to 10.3% yoy in December 2005. Continued increase in food and services prices were behind this inflation figure. It is expected that consumer price inflation may accelerate later in the year due to expected moderate agricultural harvest and increased gas price. The latter will be passed on consumers primarily via higher gas and electricity tariffs.

Monetary base and money supply increased by 44.3% yoy and 50.1% yoy respectively in January 2006. The NBU has sold almost USD 1 bn of foreign exchange reserves to support current exchange rate. As a result, money supply growth was lower in January compared to December figures and banks experienced temporary shortage of liquidity. As a reaction to the reduced banks liquidity, the NBU eased banks' access to its refinancing facilities by revising downward overnight interest rates to 11-13% p.a. from 12-15% p.a.

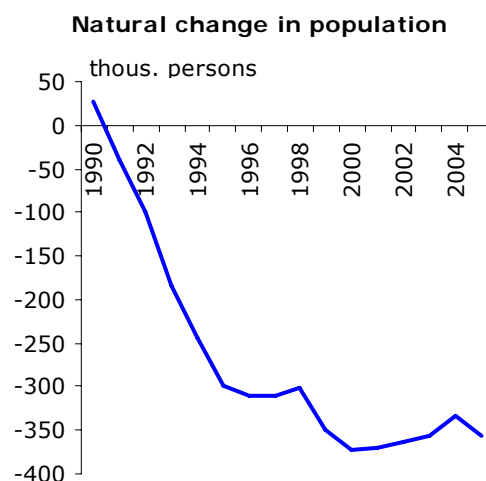
Also, foreseeing that banks may experience lack of liquid resources in the short-run due to the slowdown of foreign currency inflows, starting from March the NBU reduced the mandatory daily reserves requirements for banks. So banks have to keep 70% of accumulated required reserves for the previous reporting period on the correspondent accounts with the NBU (instead of previous 90%). This will reduce banks' demand for liquid funds thus better matching it with the supply. The supply of domestic currency on the interbank money market might reduce temporarily in March due to accumulation of resources on state treasury account on the eve of high payments on external state debt scheduled for this month. The shortage of foreign currency on the foreign exchange market may also persist at least over short-term forcing the NBU to sell its international reserves contributing to lower supply of domestic currency to the banking system.

Financial markets: Eight stock exchanges agreed to create a consolidated electronic stock exchange

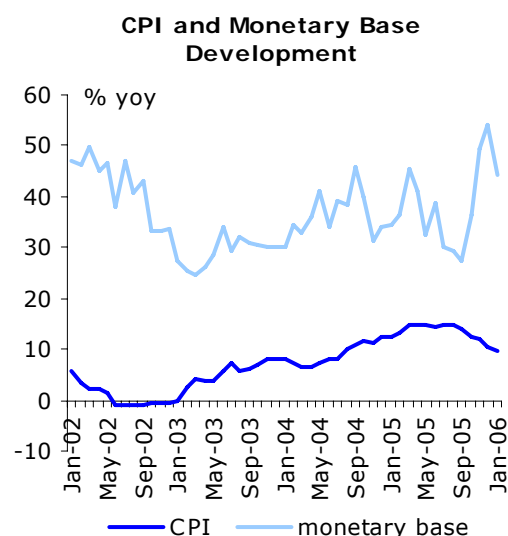
Capital markets. Eight Ukrainian stock exchanges have signed an cooperation and partnership agreement with the main purpose of creating a consolidated electronic stock exchange. This exchange will specialize on primary privatisation tenders of the State Property Fund (SPF). Later it will also provide a platform for secondary trading. The SPF and the Supervision Commission for Securities support this initiative. At the same time, market participants argue that this stock exchange might be uncompetitive compared to the PFTS, the currently dominant trade platform, which is not legally recognized as a stock exchange. In any case, the consolidation of stock exchanges could improve the stock market infrastructure in Ukraine.



Source: State Treasury



Source: Derzhkomstat



Source: Derzhkomstat, NBU



Economic Trends		Q4 04	Q1 05	Q2 05	Q3 05	Q4 05	Oct	Nov	Dec	Jan	Feb
GDP growth (real)	% yoy	8.5	5.0	3.2	1.2	...	2.2	-2.7	...	0.9	...
GDP growth (real)	% yoy cum.	12.1	5.0	4.0	2.8	2.6	2.8*	2.2*	2.6*	0.9*	...
Industrial production (real)	% yoy cum.	12.5	7.1	5.0	3.2	3.1	3.1	2.9	3.1	-2.9	...
Agricultural production (real)	% yoy cum.	19.4	3.9	6.4	3.4	0.0	1.4	1.4	0.0	3.3	...
CPI	% yoy eop	12.3	14.7	14.4	13.9	10.3	12.4	12.0	10.3	9.8	10.7
PPI	% yoy eop	24.1	22.0	17.7	14.7	9.6	12.9	10.4	9.6	10.7	8.1
Exports (USD)***	% yoy cum.	37.2	15.8	10.3	7.7	...	6.3"	5.6"	4.9"
Imports (USD)***	% yoy cum.	26.0	17.9	21.9	22.6	...	25.3"	24.6"	24.6"
Merchandise trade balance	USD bn cum.	3.74	1.05	0.82	-1.02	...	-1.02"	-1.34"	-1.85"
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	14.89	19.47	19.39
Monetary Base	% yoy eop	34.1	45.5	38.7	27.2	53.9	34.7	49.3	53.9	44.3	...
Lending rate on UAH credits **	% pa, aop	17.9'	17.0	15.4	15.4	16.4	16.1	16.2	16.4	16.0	...
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	6.07	5.96	5.99	6.10	6.04

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	418.5
Nominal GDP	USD bn	41.9	31.6	31.2	37.8	42.6	49.5	65.1	81.7
GDP growth (real)	% yoy	-1.9	-0.2	5.9	9.2	5.2	9.4	12.1	2.6 ^e
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 ^o	1.2 ^{oo}	1.4	3.1	2.9	6.8	...
Current account	% GDP	-3.1	2.9 ^o	3.8 ^{oo}	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	-1.9
Total state debt	% GDP eop	49.4	61.4	45.2	36.3	34.3	29.5	24.7	18.7
External debt (total)	% GDP eop	38.4	49.9	33.0	26.0	24.6	17.3	18.6	14.1
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

^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