



# Monthly Economic Monitor Ukraine

- On March 26 Ukrainians elected new Parliament.
- From January to February 2006, real GDP grew by 1.5% yoy.
- The National Electricity Regulatory Commission announced about gas and electricity tariff increases.
- Ukraine completed WTO membership negotiations with the USA.
- In January and February the central fiscal expenditures are executed at 85% of target.
- The Pension Fund deficit is planned at UAH 7.3 bn in 2006.
- In February inflation speeded up to 10.7% yoy.

**No.4 (66)  
April  
2006**

## Politics: Ukrainians elected new Parliament

On March 26 Ukraine voted for people's deputies to Verkhovna Rada, local councils and for mayors of cities. For the first time the elections were held on the party list basis only. According to the preliminary electronic count of votes, only five election blocks have overcome the 3% threshold. The Communist Party received 3.66%, the Socialist Party – 5.67%, the People's Union "Nasha Ukraina" – 13.94%, the Bloc of Yulia Tymoshenko – 22.27%, and the Party of Regions leads the list with 32.12% of the votes. On the edge of getting into the parliament were the radical Natalia Vitrenko's Bloc "People's opposition" with 2.93%, and block of the speaker of the previous parliament Volodymyr Lytvyn "We" with 2.43%. This were the first parliamentary elections after the Constitutional reform that enhanced the powers of the parliament at expense of the presidential power. Since now the factions in the parliament will have to form a coalition of majority of the deputies, which, in turn, will propose to the President the candidatures for ministers and the Prime Minister. Local councils were also elected via the party lists and the local majority coalitions will be formed between different forces, not necessarily represented in the parliament.

International organizations said that elections were conducted on democratic basis. However, several parties and blocs that did not overcome the 3% threshold state that falsification had place during the procedure of votes counting and demand recount of votes. The head of the Central Elections Commission Yaroslav Davydovych rejects facts of counting falsifications.

The House of Representatives of the US Congress adopted a bill cancelling the effect of the discriminatory Jackson-Vanick amendment against Ukraine. This bill was signed by the US President George W. Bush. The approval of such bill grants Ukraine the status of a regular trade partner, facilitating trade.

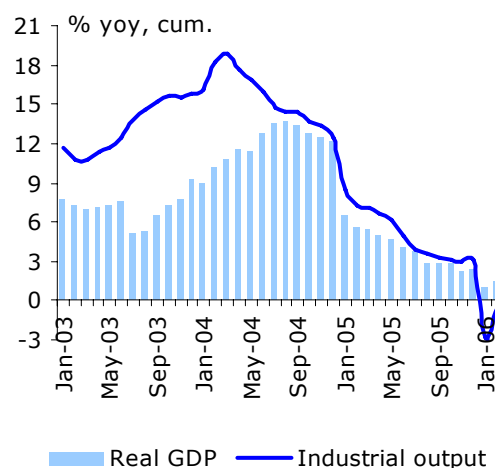
## Real economy: The real GDP growth was 1.5% yoy

According to Derzhkomstat, in the first two months of 2006 the real GDP growth was 1.5% yoy, thus a bit higher than at the beginning of the year. The acceleration is attributed to improved performance of industry and construction, backed by stable growth of agriculture and transport. In particular, extractive industry value added increased by 2.5% yoy after a reduction in January, while the drop of value added in manufacturing has almost ceased. Also, construction dropped by only 0.2% yoy. It means that a growth in construction in February almost compensated a 9% yoy reduction in January, likely signalling about a gradual revival of investment activity in Ukraine.

Although improved as compared to January, industrial output growth still was at negative 0.6% yoy between January and February due to continuous drop in manufacturing. The latter is explained by the reduction of production in metallurgy, chemical industry and petroleum refinement. For metallurgy and chemical industry, the gas price shock is one of key reasons for adverse performance. Moreover, the situation in metallurgy is aggravated by increased international competition, resulting in reduction of demand for

**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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Ukrainian products. The reduction was only partially compensated by growth in food industry and machine building.

**Sectoral trends: The National Regulatory Commission announced about gas and electricity tariff increases**

**Energy.** The National Electricity Regulatory Commission announced that it would increase the tariffs for the electricity for the households and municipalities by 25%. It has also announced about increase of the gas for all gas consumers, except for the industrial ones, who already got their tariffs increased, by 25%. These measures are related to the need to bring the tariffs in line with cost recovery principle. Price on imported gas has increased since January 2006, but due to the parliamentary elections the tariff adjustment was postponed until after elections.

**External sector: Ukraine completed WTO membership negotiations with the USA**

In March Ukraine made an important step towards the completion of WTO membership negotiations, signing the bilateral protocol of accession on markets of goods and services with the USA. It is the 39th protocol signed by Ukraine. Also, Ukraine completed WTO talks with Armenia and Columbia. Responding on demand from the USA Ukraine committed to join zero binding tariffs sectoral initiatives concerning wood, machine building products, metals, etc. However, Ukraine will not join agricultural zero initiatives concerning oil seeds, fish and beer. The conclusion of negotiations with the USA should positively affect ongoing talks with Australia and other countries. To become a member of the WTO in 2006, Ukraine also has to finalize harmonization of national legislation in line with the WTO requirements, e.g. open the market for branches of foreign banks.

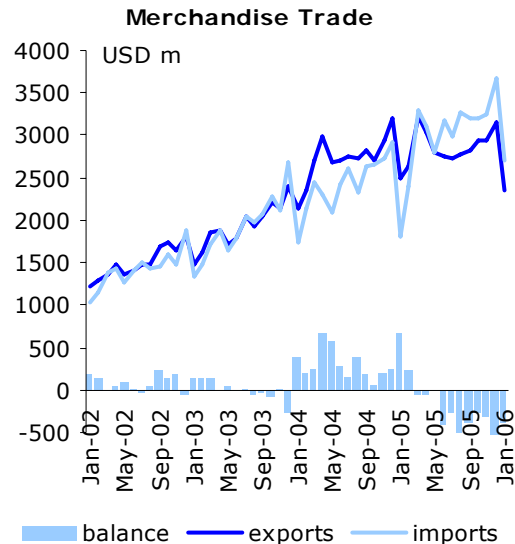
According to the Derzhkomstat, in January commodity exports dropped by 6.3% yoy in dollar terms, while imports grew by almost 50% yoy. Resulting commodity trade balance was negative at USD 373 m. The increase in imported gas price by near 70% to the large extent explains both drop in exports and growth of imports. In particular, gas price shock resulted in significant decline in chemical and metal products exports, and in discontinued exports of gas. For metals, the situation is aggravated by increased competition from China. The increase in exports of machinery and equipment has only partially compensated for this decline. On import side, alongside with higher gas imports, the growth is registered for almost all other commodity categories, reflecting strong domestic demand growth.

In March the NBU released the balance of payments data for 2005. The current account balance remained positive at USD 2.5 bn although reduced compared to USD 6.8 bn in 2004. The lower figure is explained by slowdown in commodity exports against the strong import growth that led to negative commodity trade balance at USD 1.1 bn. The major feature of 2005 balance of payments was high FDI inflow at USD 7.8 bn, explained to large extent by sales of metallurgical plant Kryvorizhstal and Aval Bank. So, the FDI inward stock increased by 80% and reached about USD 360 per capita.

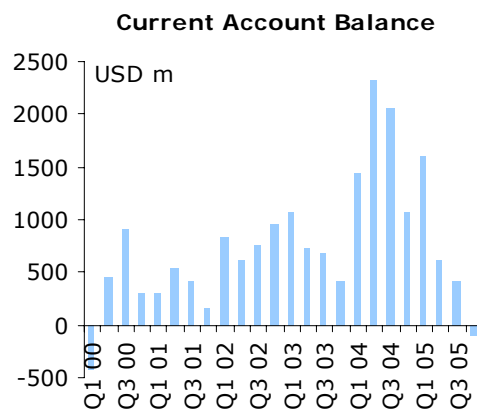
**Fiscal policy: Central surplus reached 0.85% of GDP**

Between January and February central fiscal revenues were executed at 104%, though the collection of different revenues was uneven. In particular, revenues from enterprise profits tax were by 20% below the plan, being compensated by 20% over-execution rate of the VAT. The central fiscal expenditures were at 85% of projected level. The resulting central fiscal surplus reached 0.85% of GDP (UAH 516 m).

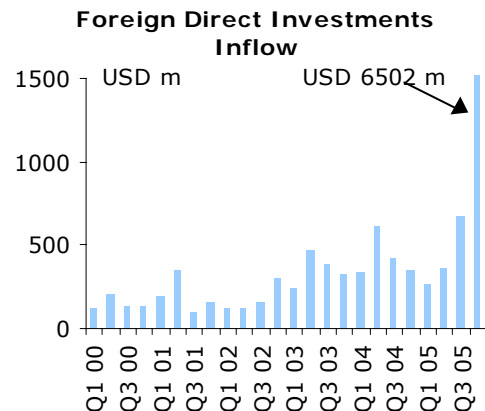
During the first quarter of 2006, the Parliament approved several amendments to the State Budget Law for 2006. As a result, the central fiscal revenues were increased by 0.7% as compared to original figure, while expenditures were expanded by 0.9%. Resulting fiscal deficit was increased by 2.6% as compared to the deficit approved in 2005, but it should not exceed 2.6% of GDP. The deficit is to be financed primarily from the residual funds at the treasury



Source: Derzhkomstat



Source: NBU



Source: NBU

account (3.5% of GDP by the end of 2005) accumulated due to the 're-privatization' of Kryvorizhstal in 2005. Additional expenditures include extra funding of parliamentary elections, social obligations of Kryvyy Rig, and obligation to finance privileges to children of war.

### Social policy: Deficit of the Pension Fund is planned at UAH 7.3 bn

In March, the government approved the Pension Fund budget for 2006 envisaging its expenditures at UAH 70.2 bn, thus by 9.6% higher than in 2005. The deficit at UAH 7.3 bn is to be financed at the expense of central fiscal transfer. The additional central fiscal transfer of UAH 8.1 bn is foreseen for paying pensions to military servants and higher pensions set according to different state pension programs. The Pension Fund will also receive central fiscal transfer at UAH 1.7 bn for compensation of losses acquired by lower contributions paid by payers of fixed agricultural tax. In January-March average pension increased to UAH 405.6 and will continue growing due to minimum pension increases in April and October 2006. It is expected that the central fiscal transfer to the Fund be increased during the year following the pattern of last two years.

### Monetary policy: Inflation speeded up to 10.7% yoy

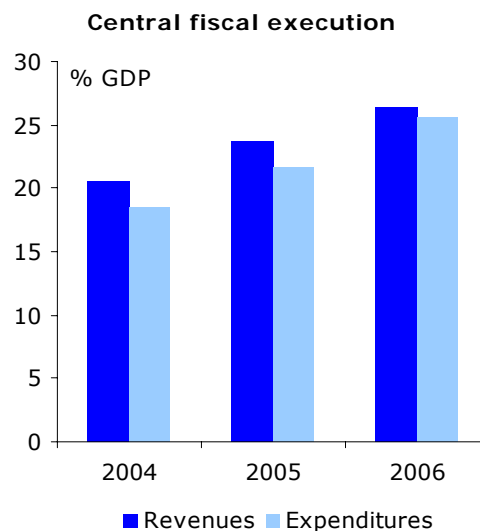
In February, inflation speeded up to 10.7% yoy, compared to 9.8% yoy in January. The acceleration of consumer price index (CPI) growth was primarily caused by rapid increase in sugar prices that surged by 25% over month. Sugar prices went up by 56.6% yoy pushing food-product prices up to 11.4% yoy. Developments of domestic sugar market was driven by world trends: as a result of increase in world sugar prices Russian sugar market overheated triggering imports from neighbouring countries, including Ukraine. It is expected that domestic sugar prices will stabilize soon, albeit at a higher level than before, following calming of the Russian market and sugar exports licensing recently introduced by Ukrainian authorities. February development of other CPI components was in line with previous months trends: non-food product prices increased by modest 4.4% yoy and services tariffs went up by 15.8% yoy.

Volume of NBU's sale interventions on the foreign exchange market reduced substantially in February. Over the month, NBU sold USD 179 m of international reserves, compared to almost USD 1 bn in January. Lower interventions contributed to looser monetary conditions. This, however, was not manifested in money supply growth that decelerated to 46.0% yoy in February, down from 50.1% yoy in January. On the one hand, the slowdown reflects the effect of increasing statistical base stemming from the renewal of deposits inflow into the banking system in early 2005. On the other hand, deposit activity of population at the beginning of 2006 was rather sluggish due to political uncertainty related to elections.

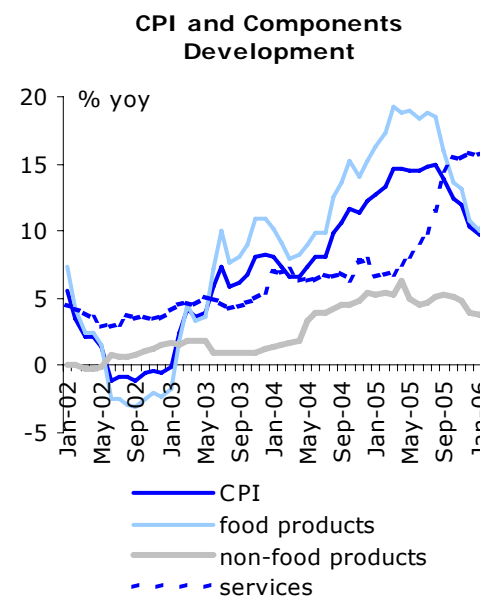
### Financial markets: Foreign banks continue to enter Ukrainian market

**Banking sector.** French bank Credit Agricole S. A. signed an agreement on purchasing 98% of Index-bank for USD 260 m. Index-bank having wide network of branches throughout Ukraine became one more bank purchased by foreign bank after Banks Agio and Aval. The deal reflects favourable expectations of foreign banks towards the growth of the Ukrainian banking market and economy as a whole. It is expected that the retail segment of Ukrainian banking market is to become more competitive bringing extra benefits for consumers of banking services.

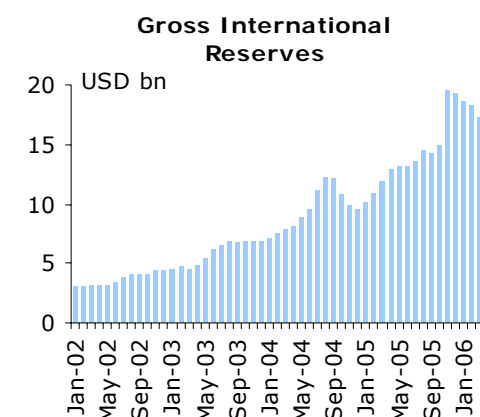
**Debt policy.** The Cabinet of Ministers allowed the Ministry of Finance to issue long-term domestic government bonds (long-term OVDP) denominated in hryvnia with maturity over 5 years. The government will have a right to redeem the bonds before maturity, which will give more flexibility to the Ministry of Finance. It is expected that the government will issue this bonds through auctions in the 2nd quarter of 2006. Currently the longest maturity OVDP are 5-year bonds that make up 35% of OVDP debt and over 4% of total state debt.



Source: State Treasury



Source: Derzhkomstat



Source: 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	2.2
GDP growth (real)	% yoy cum.	12.1	5.0	4.0	2.8	2.6	2.8*	2.2*	2.6*	0.9*	1.5*
Industrial production (real)	% yoy cum.	12.5	7.1	5.0	3.2	3.1	3.1	2.9	3.1	-2.9	-0.6
Agricultural production (real)	% yoy cum.	19.4	3.9	6.4	3.4	0.0	1.4	1.4	0.0	3.3	3.6
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.	42.6	16.9	10.9	9.0	7.5	6.3"	5.6"	4.9"	-6.3"	...
Imports (USD)***	% yoy cum.	31.3	17.4	21.5	22.3	20.4	25.3"	24.6"	24.6"	50.0"	...
Merchandise trade balance	USD bn cum.	3.74	1.02	0.78	-0.35	-1.14	-1.02"	-1.34"	-1.85"	-0.37"	...
Current account	USD bn cum.	6.91	1.60	2.22	2.63	2.53	x	x	x	x	x
Current account	% GDP, cum.	10.6	9.9	6.4	4.5	3.1	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	18.6	18.3
Monetary Base	% yoy eop	34.1	45.5	38.7	27.2	53.9	34.7	49.3	53.9	44.3	39.4
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	15.9
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 <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	42.6	7.5
Imports (gs, USD)	% yoy	-14.0	-19.1	18.9	14.1	4.9	28.7	31.3	20.4
Current account	USD bn	-1.3	0.9 °	1.2 °°	1.4	3.1	2.9	6.9	2.5
Current account	% GDP	-3.1	2.9 °	3.8 °°	3.7	7.6	5.9	10.6	3.1
FDI (net)	USD bn	0.7	0.5	0.6	0.8	0.7	1.4	1.7	6.5
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

° 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

°° 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