



Monthly Economic Monitor Ukraine

- The results of March parliamentary elections have been officially announced on April 27.
- In the first quarter real GDP increased by 2.4% yoy despite the continued decline in manufacturing.
- The 2006 grain harvest in Ukraine is forecast to be 31 m tons, thus 6.0 m tons below the previous year.
- The commodity trade deficit reached USD 1.03 bn in the first two months of the year.
- Central fiscal deficit reached 1.7% of GDP in the first quarter of 2006.
- In February household real incomes increased by 20.9% yoy.
- In March consumer price growth decelerated to 8.6% yoy.
- The NBU lost around USD 2 bn of foreign reserves in the first quarter primarily due to increased demand for cash dollars.

**No.5 (67)
May
2006**

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 results of the parliamentary elections have been officially announced

The official announcement of results of March parliamentary elections in Ukraine was postponed as several parties filed the suit in the Supreme Administrative Court against Ukrainian Central Electoral Commission (UCEC) with requirement to cancel the election results due to the violations of the election law. The court ruled out that the UCEC was acting in accordance to the law and that there were no violations of electoral norms. That allowed the UCEC to officially publish the results of the elections on April 27.

According to the UCEC, the new Parliament will consist of 186 deputies from the Party of Regions, 129 from the Block of Yulia Tymoshenko, 81 from the Nasha Ukraina, 33 from the Socialist Party, and 21 from the Communist Party. Representatives of all parties elected to the parliament will start negotiations on parliamentary procedures in early May to prepare for the first parliamentary session scheduled on May 26. In parallel the parties work on the establishment of a coalition that will unite majority of the deputies in the new parliament. According to the constitutional amendments, this coalition will decide on the formation of the Government.

Real economy: In the first quarter real GDP increased by 2.4% yoy

In the first quarter real GDP increased by 2.4% yoy despite the further reduction of value added in manufacturing by 0.8% yoy. The GDP growth was supported by the stable development of agriculture and service sectors, in particular transport. Also, a 5.0% yoy increase in construction after more than a year of decline signals about the revival of investment activity in the country. In 2005 construction dropped by 8.8%, while the real gross fixed capital accumulation reduced by 0.3% compared to 20.4% rise in 2004.

As the drop in manufacturing registered in January has almost ceased, in the first quarter of 2006 industrial output increased by 0.2% yoy. The less than one percentage drop in manufacturing was compensated by growth of extractive industry – in particular, extraction of energy materials – and of production and distribution of electricity, gas and water. The latter increased by 7.4% yoy; however, this growth is expected to decelerate during the year as it was provoked by cold winter. In manufacturing, the reduction is attributed with continued drop in production of coke and petroleum refinement, metallurgy and chemistry, as well as slower than in the previous year growth of food industry and machine building.



Source: Derzhkomstat

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Sectoral trends: In 2006 the grain harvest is expected at about 31 m tons

Agriculture. According to the consulting agency UkrAgroConsult, in 2006 the grain harvest is expected at about 31 m tons, which is 6.0 m tons lower than in 2005. This decline is attributed mostly to the fall in winter wheat harvest, which is expected to be 6.8 m tons less than in the previous year. At the same time barley harvest is forecast to exceed the 2005 harvest by about 1 m tons. The fall of winter wheat harvest might push up the prices of food wheat and thus bread. However, the livestock-breeding sector is not expected to have problems with feed wheat this year, since the areas under killed winter wheat is likely to be re-seeded with spring wheat.

Energy. Recently the US Department of Justice allegedly started the investigation concerning activities of Rosukrenergo, an intermediary involved in newly signed Russian-Ukrainian gas contract. The news of the possible investigation has already provoked a leakage of information about the real owners of the company. While before it was known that half of Rosukrenergo is owned by Gazprom, the Russian state company, and the other half by the Raiffeisen Investment on behalf of private individuals, now the names were made public. As reported, Ukrainian businessmen Dmytro Firtash and Ivan Fursin own 45% and 5% respectively. Some observers relate Dmytro Firtash with businessman Semen Mogilevich, who is wanted by the FBI. International attention to the Ukrainian-Russian deal and parties involved is likely to further complicate forthcoming Russian-Ukrainian talks on the conditions of gas supply to Ukraine.

Infrastructure Following the decree of a former mayor of Kyiv city, new multi-utility company Kyivenergoholding, consisting of Kyivgas, Kyivenergo, and Kyivvodokanal, was registered in April. The 61% of statutory belongs of new company belongs to Kyiv municipality, while the rest is owned by private companies Denssec Ltd (20%) and Zarova Ltd (19%). In 2004 the Anti-Monopoly Committee allowed this merger; however, this permit had already expired a year ago. Thus, the registration of the holding can be successfully disputed in the court. Although the merger is aimed to improve performance of local utilities, in the absence of appropriate regulation and a lack of competitive tender this decision could only limit the scope for future competition.

External sector: The commodity trade deficit reached USD 1.03 bn in the first two months of the year

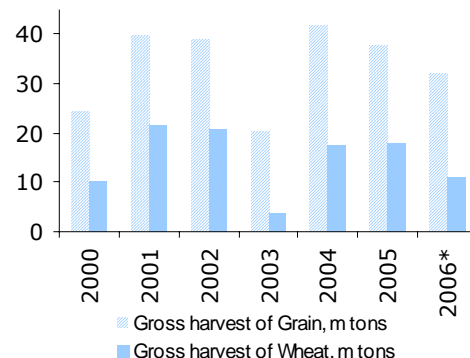
According to the Derzhkomstat, between January and February 2006 commodity exports decreased by 5.4% yoy in dollar terms, mainly due to 9.6% drop in exports of metal products and 29.0% reduction in exports of mineral products, in particular energy resources, the exports of which is licensed in 2006. Geographically, exports dropped to Europe and Asia, key consumers of Ukrainian mineral products and metals. The growth of all key import positions, resulted in 39.6% yoy increase in commodity imports in dollar terms, aggravated the negative balance of commodity trade. Accordingly, the commodity trade deficit reached USD 1.03 bn compared to a surplus of USD 0.92 bn in the same period of previous year.

According to the preliminary information of the NBU, in the first quarter of 2006 the current account balance will feature a deficit of around USD 0.8 bn compared to a surplus of USD 1.6 bn in the same period of the previous year. This worsening in the current account balance is explained primarily by significant deterioration of the commodity trade balance.

Fiscal policy: Central fiscal deficit reached 1.7% of GDP

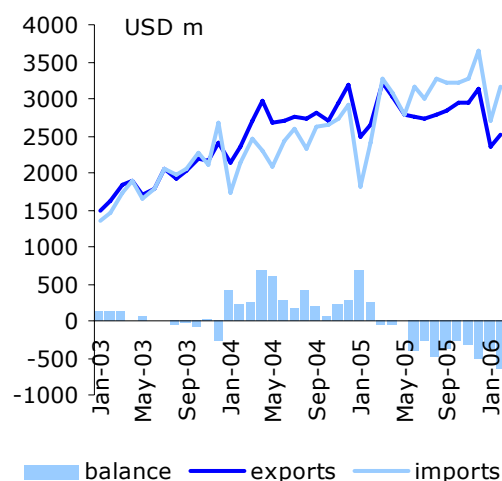
In the first quarter of 2006 there were a significant shortfall of enterprise profit tax (EPT) revenues that was UAH 1 bn or 22% below the target, attributed to much lower economic activity in the country against the background of gas price shock and parliamentary election campaign. Despite this trend, the central fiscal revenues were executed at 102.7%. It became possible due to considerable

Crop Production Development



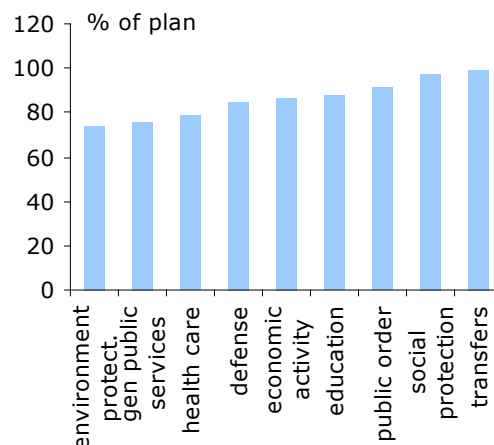
Source: Derzhkomstat
* - forecast

Merchandise Trade



Source: Derzhkomstat

Central Fiscal Expenditures in the first quarter 2006



Source: State Treasury

over-execution of the VAT that was UAH 1.4 bn or 17% above the projection level. Higher than planned VAT collection is explained mostly by high import growth. Other factor that allowed to counterweight falling EPT revenues was over-execution of profits from state owned enterprises, directed to the state coffers, which were UAH 0.2 bn or 95% above the fiscal plan.

The central fiscal expenditures were executed at 91.3% of the fiscal plan. Social payments, health care, and education expenditures had the highest rate of cash execution. Despite the under-execution of the expenditures, the fiscal balance turned from the positive in the first two months of the year into deficit, which reached UAH 1.6 bn or 1.7% of GDP.

Social policy: Household real incomes grew by 20.9% yoy in February

In February 2006 real incomes of households grew by 20.9% yoy due to increase in both wages and monetary social transfers. In particular, real wages grew by 28.0% yoy, while social transfers, including pensions and stipends, increased by 21.6% yoy. Compared to 2005, the share of wages in total incomes increased and exceeded the share of incomes from social transfers, indicating the restoration of labour incentives on the market. Taking into account minimum wages and pensions increases foreseen for 2006 by the Budget Law, incomes are expected to grow further, though at a bit slower pace than in 2005.

Monetary policy: Consumer price growth decelerated to 8.6% yoy

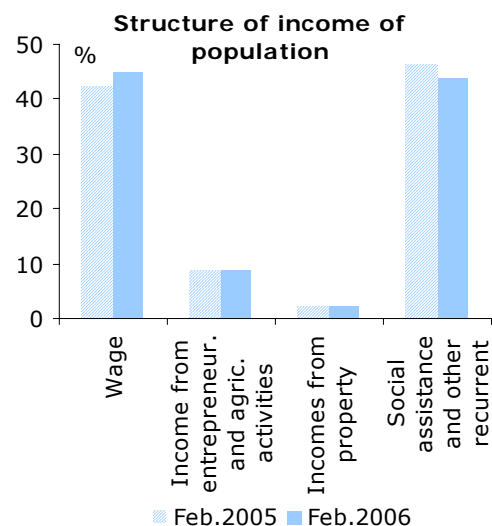
Consumer price growth decelerated to 8.6% yoy in March against 10.7% yoy in February, reducing by 0.3% in monthly perspective. This was caused mostly by fall of food prices explained by bouncing back of peaked prices for vegetables and potatoes, and increased supply of dairy products on domestic market after Russia banned its imports from Ukraine. The increased demand for foreign cash on the eve of elections also helped to suppress inflation, as less money were directed on food market.

The main challenge for the monetary policy in the first quarter of 2006 was accommodating with the spike of demand for US dollars, provoked by political uncertainty and deteriorating trade balance. To satisfy the increased demand, the NBU was selling foreign reserves restraining the growth of monetary aggregates. Although increased refinancing of commercial banks and rise in government spending in March partially balanced out the retraining effect of sales of foreign exchange, in March monetary base and money supply increased by 25.2 % yoy and 30.9 % yoy respectively, thus considerably slowing compared to the previous periods.

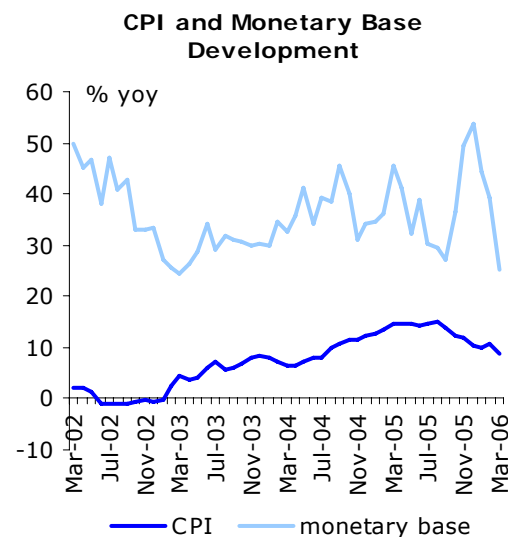
Financial markets: NBU foreign reserves reduced by almost USD 2 bn during the first quarter

Exchange rate. Political uncertainty on the eve of parliamentary elections against the background of negative and falling commodity trade balance led capital outflow and the temporary increase in demand for foreign cash by households, stressing the inter-bank foreign exchange market in the first quarter of 2006. To protect the exchange rate, the NBU intervened on the market by selling foreign reserves. During the first three months of the year the NBU lost USD 2 bn or around 11% of gross reserves, including USD 1 bn in March. As of the end of March, the gross foreign reserves were USD 17.3 bn. It is expected that the drain of reserves will slow later in a the year.

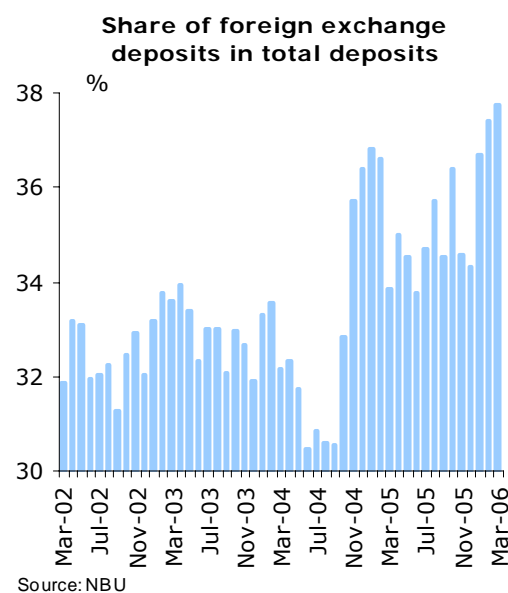
Banking sector. On the eve of parliamentary elections political uncertainty provoked an increase in the level of dollarisation. The share of foreign currency bank deposits has been growing for the third month in the row and reached 37.7% in March compared to 34.3% in December 2005. It is expected that the trust in national currency restores later in the year after the new Government will be formed.



Source: Derzhkomstat



Source: Derzhkomstat, NBU



Source: NBU



Economic Trends		Q1 05	Q2 05	Q3 05	Q4 05	Q1 06	Dec	Jan	Feb	Mar
GDP growth (real)	% yoy	4.9	3.4	1.4	1.7	2.4	...	0.9	2.2	4.0
GDP growth (real)	% yoy cum.	4.9	4.1	3.0	2.6	2.4	2.6*	0.9*	1.5*	2.4*
Industrial production (real)	% yoy cum.	7.1	5.0	3.2	3.1	0.2	3.1	-2.9	-0.6	0.2
Agricultural production (real)	% yoy cum.	3.9	6.4	3.4	0.0	4.0	0.0	3.3	3.6	4.0
CPI	% yoy eop	14.7	14.4	13.9	10.3	8.6	10.3	9.8	10.7	8.6
PPI	% yoy eop	22.0	17.7	14.7	9.6	6.5	9.6	10.7	8.1	6.5
Exports (USD)***	% yoy cum.	16.9	10.9	9.0	7.5	...	4.9"	-6.3"	-5.4"	...
Imports (USD)***	% yoy cum.	17.4	21.5	22.3	20.4	...	24.6"	50.0"	39.6"	...
Merchandise trade balance	USD bn cum.	1.02	0.78	-0.35	-1.14	...	-1.85"	-0.37"	-1.03"	...
Current account	USD bn cum.	1.60	2.22	2.63	2.53	...	x	x	x	x
Current account	% GDP, cum.	10.1	6.3	4.5	3.0	...	x	x	x	x
Gross international reserves	USD bn eop	11.95	13.07	14.26	19.39	17.3	19.39	18.6	18.3	17.3
Monetary Base	% yoy eop	45.5	38.7	27.2	53.9	25.2	53.9	44.3	39.4	25.2
Lending rate on UAH credits **	% pa, aop	17.0	15.4	15.4	16.4	15.8	16.4	16.0	15.9	15.8
Exchange rate (official)	USD aop	5.30	5.10	5.05	5.05	5.05	5.05	5.05	5.05	5.05
Exchange rate (official)	EUR aop	6.95	6.43	6.19	6.00	6.07	5.99	6.10	6.04	6.07

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	424.7
Nominal GDP	USD bn	41.9	31.6	31.2	37.8	42.6	49.5	65.1	83.1
GDP growth (real)	% yoy	-1.9	-0.2	5.9	9.2	5.2	9.4	12.1	2.6
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 ^o	1.2 ^{oo}	1.4	3.1	2.9	6.9	2.5
Current account	% GDP	-3.1	2.9 ^o	3.8 ^{oo}	3.7	7.6	5.9	10.6	3.0
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	-1.82
Total state debt	% GDP eop	49.4	61.4	45.2	36.3	34.3	29.5	24.7	18.40
External debt (total)	% GDP eop	38.4	49.9	33.0	26.0	24.6	17.3	18.6	10.35
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