



Monthly Economic Monitor Ukraine

- The first session of newly elected Parliament has started on May 25, two months after an election in March.
- In the first four month real GDP increased by 2.7% yoy thanks to growing services and agriculture.
- The Cabinet of Ministers has approved a 50% increase in tariffs for domestic railway passenger transportation.
- Within the WTO membership negotiations framework Ukraine signed a protocol on access to markets of goods and services with Australia.
- The merchandize trade deficit reached USD 1.8 bn in the first quarter because of dropping exports and surging imports.
- In April real wages grew by 24.9% yoy
- Despite increase in tariffs on gas and electricity, the CPI growth decelerated to 7.3% yoy in May.
- Small banks are struggling to meet capital requirements.

**No.6 (68)
June
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 first session of newly elected Parliament has started on May 25

The first session of newly elected Parliament has started on May 25, two months after an election in March. According to the amended Constitution, now the Verkhovna Rada has 30 days to form ruling coalition. Representatives of so-called "Orange coalition" called for a break in the work of Parliament until June 7 to work out the final text of the coalition agreement. There is a strong likelihood that Bloc "Our Ukraine", Socialist party and Block of Yulia Tymoshenko will reach agreement and form a new government.

Many of the current senior officials in the executive branch of power were elected as deputies to the parliament. According to the Constitution, they are obliged to resign from their positions in the executive branch prior to receiving the mandates. Several important changes has already occurred. In particular, Volodymyr Gorbulin, advisor to the President, became acting Secretary of the National Security and Defence Council starting to work after Anatoliy Kinakh. Olexiy Ivchenko left the position of the Head of the NAK "Naftogaz Ukrainy", Ukrainian energy giant, due to his election to the parliament. Ministers still keep their positions, while most of them have already became deputies, as it is legally required for ministers to continue working before the next government steps up.

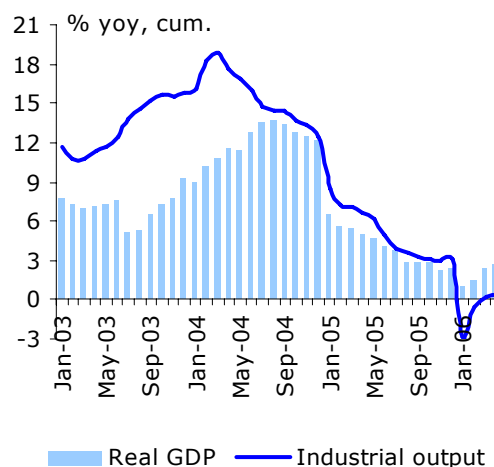
Real economy: In the first four months real GDP increased by 2.7% yoy

In the first four months of the year real GDP increased by 2.7% yoy, gradually accelerating compared to the beginning of the year. The major contributors to the GDP growth were service sectors, in particular trade and transport, and agriculture. At the same time, the reduction in manufacturing continued against the background of high gas prices. The 6.7% yoy rise in construction reflects the revival of investments.

On demand side, the growth of GDP was due to a steady growth of final consumption of households and a resurgence of investments. According to the Derzhkomstat, investments in the fixed capital increased by 15.9% yoy in the first quarter of 2006, significantly speeding up as compared to 4.5% yoy in the same period of 2005. The upturn of investment activity is especially positive, as it is one of key factors for ensuring the long-term stable growth of Ukraine's economy.

Industrial output increased by 0.4% yoy between January and April compared to 6.7% growth in the same period of the previous year. The low growth figure is explained by continuous reduction of production in chemical industry, metallurgy, and petroleum

GDP and Industrial Output



Source: Derzhkomstat

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refinement, as well as relatively low rates of growth in food industry. One of the key factors adversely affecting manufacturing is increased gas price, hurting chemical and metal production. Another reason is almost completely banned exports of dairy products to Russia, hurting food industry.

Sectoral trends: Rise in railway tariffs is approved

Infrastructure. The Ministry of Transport and Communications has approved a 50% increase in tariffs for domestic railway passenger transportation. However, as supplementary duties will not be changed, tickets price will be increased by 34% on average. The increase will come into force from June 12, 2006. The respective decree of the Ministry also foresees increases of the railway passenger tariffs in January, April and July 2007 by 10 % each time. This tariff increase will moderately improve cost-coverage of railway passenger transportation as well as reduce cross-subsidization in the industry.

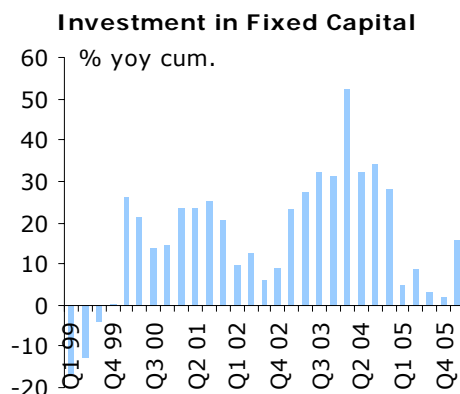
External sector: Ukraine signed a bilateral protocol with Australia in the framework of WTO membership talks

In May Ukraine made one more important step towards the membership in the WTO. It has signed the protocol on accession to markets of goods and services with Australia, thus completing negotiations with 45th country. These particular talks were among the most difficult for Ukraine, as the cornerstone of negotiations was agricultural policy. At present the Ukrainian agro-food sector is the most protected sector of the economy. It is expected that Ukraine's membership in the WTO will result in reduction of protectionism in this sector benefiting consumers and enhancing efficiency in the economy. To complete the WTO accession procedures, Ukraine still has to sign several bilateral protocols and, more importantly, amend some legislation, in particular, concerning state support in agriculture, export tariffs, and harmonization of standards in line with the WTO regulations. Also, Ukraine has to complete the Final Report of the Working Party. The government is optimistic concerning Ukraine's accession to the WTO in 2006. However, due to possible delays with adopting required legislation and ratification of the WTO membership agreement in the Verkhovna Rada, the mid-2007 seems to be more realistic as a closing date.

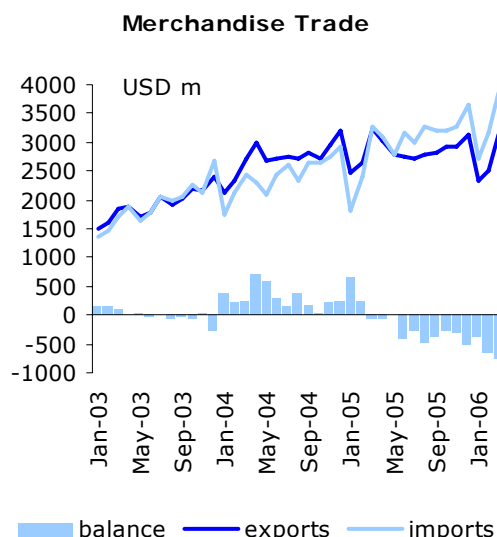
According to the Derzhkomstat, in the first quarter of 2006 Ukraine's merchandise trade balance continued deteriorating. Commodity exports dropped by 4.4% yoy in dollar terms, while imports increased by 30.2% yoy. As a result, the trade deficit reached USD 1.8 bn compared to positive balance at USD 0.9 bn in the same period of 2005. The major factors behind the deficit are the increased price for imported gas, pushing up value of imports and hurting export-oriented metallurgy and chemical industry, and intensified competition of world metal markets. It is expected that the trade deficit will be maintained in 2006.

Fiscal policy: Central fiscal revenues have remained above the target thanks to high VAT collections

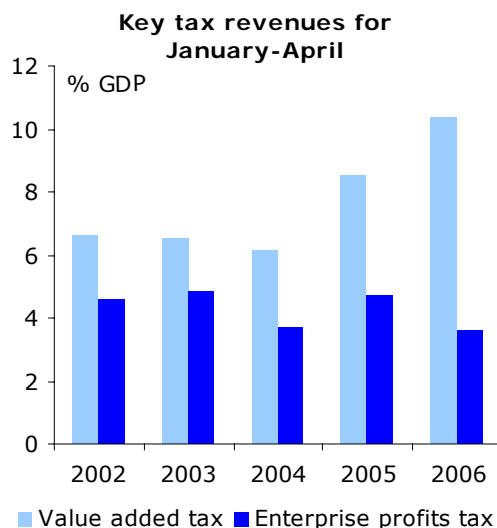
Between January and April central fiscal revenues were 2.2% above the government plan for the period. The good performance was mainly due to overexecution of VAT revenues by 17% and profits of state owned enterprises payable to state coffers by 65%. The weight of VAT in GDP for the first four months of 2006 has reached 10% due to substantial tax base broadening occurred in spring of 2005, strong growth of consumption, and increasing share of import in GDP that overpasses export dynamics. At the same time, enterprise profits tax was executed at 79%, thus creating additional fiscal gap of UAH 1.3 bn. For the period, central fiscal expenditures were executed at 92%. The execution of social protection and transfers to the local budgets was at the highest level of 97%-98%, while utility sector, culture, and environment protection expenditures execution rate did not exceed 75%. The resulting central fiscal deficit reached UAH 3.2 bn



Source: Derzhkomstat



Source: Derzhkomstat



Source: State Treasury, Derzhkomstat



or 2.5% of GDP. At the same time, it was 40% smaller than the government plan for the period.

Social Sector: In April real wages grew by 24.9% yoy

Continuing the previous years trend, in the beginning of 2006 the real wages maintained high growth pace. In April they increased by 24.9% yoy. The growth was mainly attributed to the minimum wage increase to UAH 350 from January 2006 and increase of wages in state administration sector. Legislation amendments that became effective from January 2006 also stimulated wage growth. According to these amendments, minimum wage does not anymore include additional payments, premiums, etc. Besides, if the enterprise uses tariff scale for setting wages, the salary for the first tariff grade must be set at higher level than minimum wage.

The average wage in April equalled to UAH 984.3. As before wages in agriculture remained the lowest, while the highest wages were still paid in financial intermediation sector. The state administration sector kept the highest growth rates of wages at 67% yoy in real terms, while the lowest growth rates were observed in industrial sectors at 17% yoy. Such manufacturing industries as coke production and petroleum refinement as well as metallurgy were lagging behind in wage increases. The latter might be explained by worsened world market conjuncture, gas price shock and last year revaluation of hryvnia that adversely affected these sectors' growth.

Monetary policy: Consumer price growth decelerated to 7.3 % yoy

Consumer prices inflation further slowed to 7.4% yoy in April and 7.3% yoy in May compared to 8.6% yoy in March marking four months of consecutive deceleration in price growth. Moderation of price growth can be attributed to ban on exports of dairy products to Russia and continued fall of sugar and potato prices after spike in February. Energy prices and tariffs increased by 19.9% yoy in May, although their contribution to inflation was counterbalanced by reductions in food prices. Increases in administratively regulated tariffs are expected to be the main drivers of inflation over next months, as other prices can be expected to grow slowly.

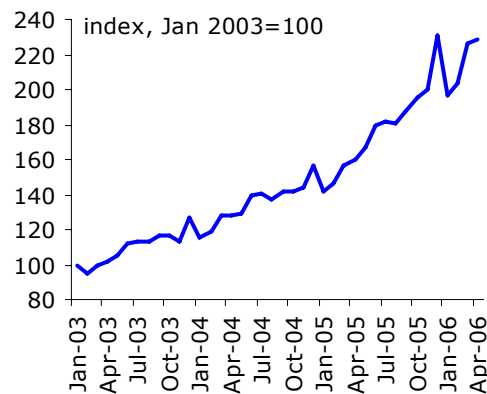
Drain of liquidity from banking system stopped as the NBU infused cash into the banking sector and slowed down sales of dollars from foreign reserves. In April monetary base and money supply increased by 24.0% yoy and 37.2% yoy respectively, which was slightly lower than in March. Monetary policy tightening is unlikely over next few months as economy is still absorbing gas price shock and might experience another gas price increase.

Financial markets: Small banks are struggling to meet capital requirements

Banking sector. Small banks are struggling to meet new requirements for regulatory capital needed for such operations as foreign exchange transactions, external borrowing, and investment activities set by the NBU in October 2005. The new requirements vary between EUR 5.5 m and EUR 20 m. As of April 1, the number of banks that did not have enough regulatory capital ranged from 11 to 93 depending on type of transactions. These banks should raise additional capital or engage in mergers to fulfil capital requirements until December 30, 2006. Otherwise their licenses for some operations will be revoked, the step that may cause disruption of banking sector and will undermine business of small banks.

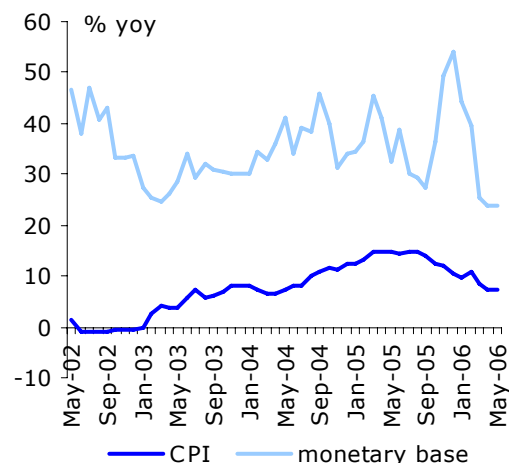
Exchange rate. The NBU increased its foreign reserves by USD 486 m in May, as supply of foreign currency on inter-bank market increased and net foreign cash demand from households dampened. As the pressure on hryvnia is likely to increase against the worsening trade balance, although partially offset by the downward trend of USD against euro and increased FDI and other capital inflows, the Head of NBU Mr. Stelmakh warned that the NBU will allow more flexibility of exchange rate.

Real Wage Index



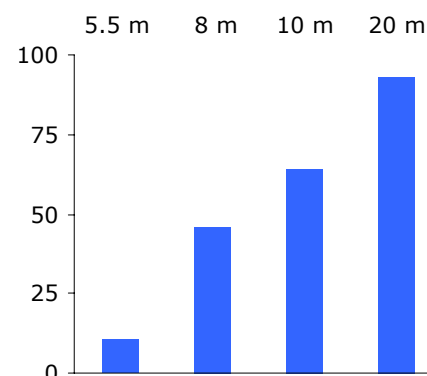
Source: Derzhkomstat

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

Number of banks with regulatory capital less than EUR



Source: Association of Ukrainian banks



Economic Trends		Q1 05	Q2 05	Q3 05	Q4 05	Q1 06	Dec	Jan	Feb	Mar	Apr	May
GDP growth (real)	% yoy	4.9	3.4	1.4	1.7	2.4	...	0.9	2.2	4.0	3.5	...
GDP growth (real)	% yoy cum.	4.9	4.1	3.0	2.6	2.4	2.6*	0.9*	1.5*	2.4*	2.7*	...
Industrial production (real)	% yoy cum.	7.1	5.0	3.2	3.1	0.2	3.1	-2.9	-0.6	0.2	0.4	...
Agricultural production (real)	% yoy cum.	3.9	6.4	3.4	0.0	4.0	0.0	3.3	3.6	4.0	4.1	...
CPI	% yoy eop	14.7	14.4	13.9	10.3	8.6	10.3	9.8	10.7	8.6	7.4	7.3
PPI	% yoy eop	22.0	17.7	14.7	9.6	6.5	9.6	10.7	8.1	6.5	5.4	4.8
Exports (USD)***	% yoy cum.	16.9	10.9	9.0	7.5	...	4.9"	-6.3"	-5.4"	-4.4"
Imports (USD)***	% yoy cum.	17.4	21.5	22.3	20.4	...	24.6"	50.0"	39.6"	30.2"
Merchandise trade balance	USD bn cum.	1.02	0.78	-0.35	-1.14	...	-1.85"	-0.37"	-1.03"	-1.77"
Current account	USD bn cum.	1.60	2.22	2.63	2.53	...	x	x	x	x	x	x
Current account	% GDP, cum.	10.1	6.3	4.5	3.0	...	x	x	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	17.2	17.7
Monetary Base	% yoy eop	45.5	38.7	27.2	53.9	25.2	53.9	44.3	39.4	25.2	24.0	23.9
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	15.7	15.3
Exchange rate (official)	USD aop	5.30	5.10	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.1	5.1
Exchange rate (official)	EUR aop	6.95	6.43	6.19	6.00	6.07	5.99	6.10	6.04	6.07	6.18	6.42

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