



# Monthly Economic Monitor Ukraine

- In June there was a first attempt to create a parliament coalition.
- In the first five months the growth of real GDP reached 4.0% yoy.
- The imported gas prices in July-September 2006 will remain at USD 95 per thousands cubic meters at the border.
- In the first quarter of 2006 the current account was in deficit at USD 0.7 bn.
- In June Ukraine continued the process of the WTO accession.
- Between January and May 2006 the central fiscal deficit reached 0.9% of GDP.
- Around 1.7% of households received utility and housing subsidies during first five months of 2006.
- The CPI growth decelerated to 6.8% yoy in June.

No.7 (69)  
July  
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 attempt of forming the Parliamentary Coalition

On June 22 after long-lasting suspensions and negotiations the Bloc of Yulia Tymoshenko (BYT), the People's Union Nasha Ukraina, and the Socialist Party announced the creation of the Parliamentary Coalition. According to the Constitution, that made them responsible for government formation. The position of the Prime Minister and economic ministers were reserved to the quota of the BYT, while the Speaker of the Parliament was to be nominated by the Nasha Ukraina. However, in June the Speaker and the government members were not appointed due to the lack of agreement on the person of the Speaker and later because the parliament tribute was blocked by the deputies from the Party "Regions of Ukraine". The latter political force was outside this coalition, though having received the majority of votes during parliament elections.

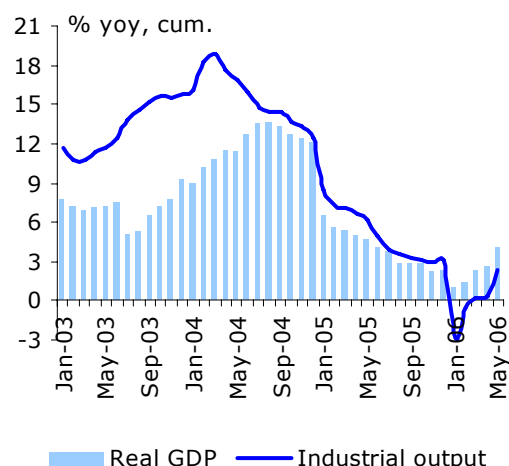
The delay in the start of normal work of Verkhovna Rada harmed the political situation in Ukraine. In particular, a special law allowing the military trainings between Ukrainian and American armies was not approved by the Parliament. Therefore, the scheduled arrival of the U.S. military ship to city Feodosia in Crimea caused public protests initiated by several political parties, in particular, pro-Russian party of Nataliya Vitrenko, which was among the winners in the local elections in Crimea in March. Consequently, the political situation further destabilized and military training was canceled.

## Real economy: The real GDP growth was 4.0% yoy

According to the Derzhkomstat, in the first five months the growth of real GDP reached 4.0% yoy, considerably speeding as compared to 2.7% yoy observed in the previous month. The acceleration of the real GDP growth is attributed primarily to the renewal of growth in manufacturing industry that reached 1.9% yoy. The continued rise of value added in agriculture, construction and services, in particular transport and trade, also contributed to the real GDP growth. However, the likelihood that such growth rates will be maintained till the end of the year is quite low. The major risks are higher gas prices, the change in world conjuncture on metal markets, and the expected modest grain harvest that will dampen the growth in agricultural value added in the second half of the year.

Industrial output increased by 2.4% yoy between January and May 2006, while in the first four months the growth was only 0.4% yoy. This is explained by revival of production in manufacturing, in particular, the recovery of metallurgy production. After several months of decline, in May the metallurgy increased by 12.4% yoy, thus allowing the five-month figure to turn to positive 1.7% yoy. The major reasons behind better performance of metallurgy are increase of world steel price as well as more aggressive marketing policy of enterprises.

GDP and Industrial Output



Source: Derzhkomstat

Institute for Economic Research  
and Policy Consulting  
Reytarska 8/5-A, 01034 Kyiv  
Tel. (+38044) 278-6342  
Fax (+38044) 278-6336  
E-mail: institute@ier.kiev.ua  
<http://www.ier.kiev.ua>

## Sectoral trends: Imported gas prices are announced to remain at the current level

**Energy.** According to the announcement of the Prime Minister Yuriy Yekhanurov, Rosukrenergo and Ukrigasenergo have agreed on gas supply to Ukraine at USD 95 per thousands cubic meters (tcm) at the border for July-September 2006. The terms of gas supply for the rest of the year are subject to further negotiations. The preservation of the imported gas price has positive short run impact, as provides more time for companies to adjust to the price shock.

The Ministry of Justice registered the order of the National Electricity Regulation Commission on domestic gas tariffs increase from July 1. Tariffs are increased for households by almost 80% to UAH 414 per tcm, for industry by 18% to UAH 648 per tcm, and for district heating companies by 80% to UAH 686 per tcm. This, in turn, will force other utility companies to increase tariffs for their services. The tariff increases are aimed to approach cost-covering level with simultaneous reduction of cross-subsidization, improve financial viability of sector and reduce overall price distortions. At the same time, the problem of payments collection as well as compensations to low income households are still in the agenda of policy makers.

**Agriculture.** In June the Cabinet of Ministers introduced minimum prices for wheat, rye and raw milk. However, it is highly unlikely that market participants will follow these minimum prices due to scarce government financing directed to maintain them. The introduction of minimum prices reveals fundamental misconception on the functioning of market mechanisms in the food value chain. Such counterproductive policy will have a negative impact on real farm-gate prices as it increases costs for collection, processing and marketing for traders and processors, which perform important functions of creating and extending market outlets for farmers. Therefore, this policy will not lead to the expected by the government results of maintaining high farm-gate prices for farmers and low retail prices for consumers. Instead the government should introduce measures to increase competition, transparency and investment in the food value chain.

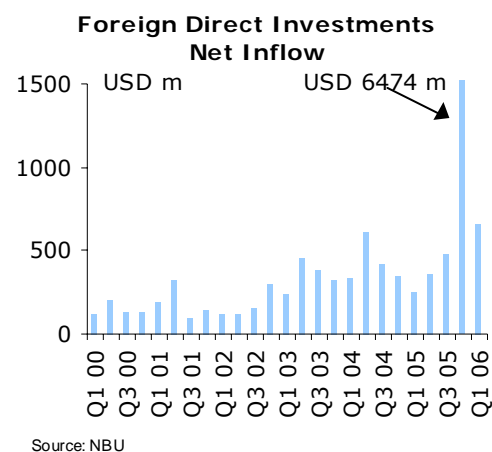
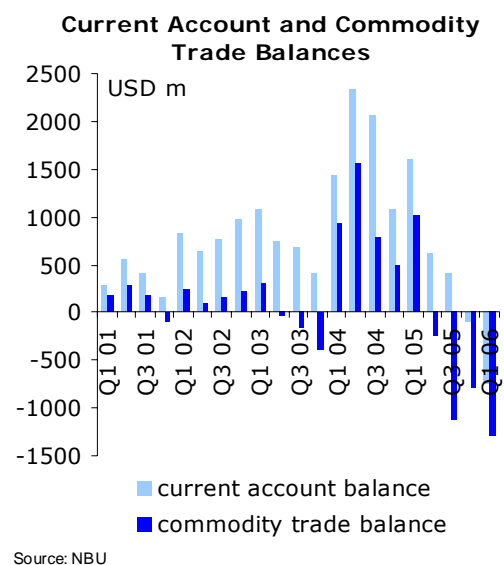
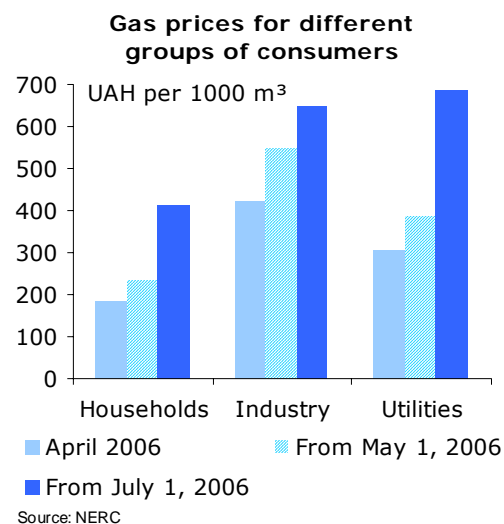
**Privatization.** To meet the privatization target for 2006, performed for the first six months at around 5.0% of yearly planned figure, the government has made the attempts to stir up privatization activity by approving amendments to the list of enterprises for privatization. Now it is planned to sell the control asset shares of the joint stock insurance company "Oranta" and JSC "Balaklava ore factory named after Gorkiy". The approved amendments increase likelihood of executing the privatization plan set at around UAH 2 bn for 2006.

## External sector: The current account deficit reached USD 0.7 bn in the first quarter

According to the NBU, in the first quarter of 2006 the current account (CA) was in deficit at USD 0.7 bn continuing the trend started in the last quarter of 2005. This deficit is attributed to ongoing deterioration of the balance of trade in goods that reached minus USD 1.3 bn due to 4.0% yoy reduction in exports and 26.3% yoy growth in imports. One of key factors behind trade deficit was increased imported gas price, inflating the value of imports and hurting exports of mineral products, metals and chemical products. Lower world metal prices and higher competition also contributed to drop in exports. Higher inflow of foreign direct investments (FDI) helped to finance the CA deficit. The FDI inflow was at USD 0.7 bn compared to USD 0.3 bn in the same period of 2005. At the same time, the outflow of short-term capital at USD 2.7 bn led to reduction of official reserves.

According to the Derzhkomstat, in the first four months of 2006 the goods exports reduced by 3.9% yoy in dollar terms, while imports grew by 23.2% yoy. The resulted deficit reached almost USD 2.1 bn.

In June Ukraine continued signing the bilateral protocols of access to markets of goods and services in the framework of the WTO accession negotiations. In particular, Ukraine signed protocols with



Egypt and Columbia, and initialed a protocol with Chinese Taipei. Altogether, Ukraine completed bilateral talks with 49 countries. It still has to reach agreement with Kyrgyzstan that demanded the repayment of some debts as a condition for signing the protocol. Along with completing bilateral talks, Ukraine has to harmonize the legislation in line with the WTO requirements. Although the President Viktor Yushchenko expects Ukraine become the member of the WTO in the autumn, the failure to amend legislation and expected hot debates in the Parliament concerning ratification of the WTO membership agreement may significantly hamper the process.

**Fiscal policy: Central deficit reached 0.9% of GDP**

Between January and May, the central fiscal revenues were executed at 102% due to the over-execution of VAT by 17% and profits of state-owned enterprises due to the state coffers by 15%. As before, enterprise profit tax was under-executed by 17% of the plan. The central fiscal expenditures were below the target by 7%. Somewhat better performance of expenditures execution as compared to first four months of the year was due to the higher share of social payments in total expenditures, which traditionally has the highest rate of the execution. The resulting central fiscal deficit reached UAH 1.5 bn (0.9% of GDP).

**Social policy: Around 1.7% of households received utility and housing subsidies**

According to the Derzhkomstat, around 1.7% of households received utility and housing subsidies between January and May 2006 and around 1% of households received cash subsidies for purchasing liquefied gas and fuel. These subsidies amounted to UAH 9.0 m and UAH 47.4 m respectively. Due to the raised tariffs for gas and electricity and expected increase in tariffs for utility and housing services, the number of households eligible for housing and utility subsidies will grow. The official estimates of required additional fiscal financing varies from UAH 0.5 bn to UAH 1.3 bn for 2006.

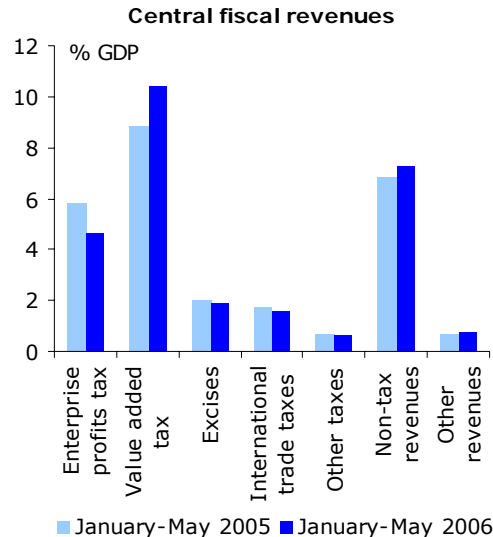
**Monetary policy: Inflation continues to slow in June, but is expected to pick up again later this year**

Consumer prices inflation slowed to 6.8% yoy in June from 7.3% yoy in May marking five months of consecutive deceleration in price growth. Lower price growth can be attributed to continued ban on exports of dairy products to Russia. Increases in administratively regulated tariffs, especially in gas tariffs in July, are expected to be the key factors contributing to inflation over next months.

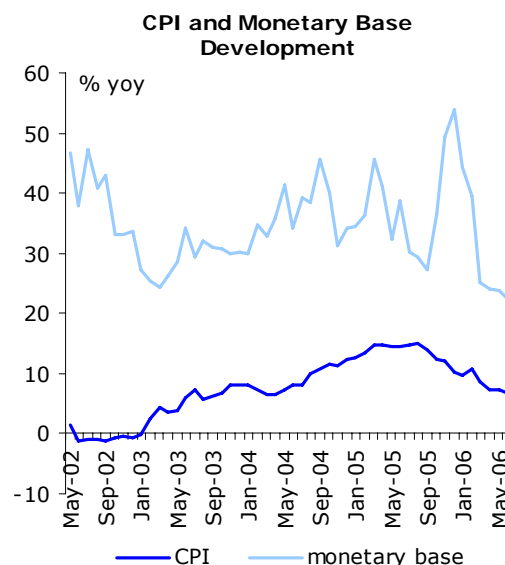
In June the NBU continued introducing measures aimed at increasing banking liquidity. In particular, the NBU lowered discount rate from 9.5% to 8.5%, and rates for collateral and blank overnight credits to 10% and 11% respectively, contributing to increase in banking liquidity. The NBU also allowed refinancing against bank deposits held in the NBU and cancelled lower limits for interest rates on overnight loans, which will have an effect in the longer run. However, overall impact of implemented measures is quite narrow and inter-bank credit market is likely to remain main source to cover shortage of liquid resources for commercial banks. In June, monetary base and money supply increased by 22.4% yoy and 37.0% yoy respectively.

**Financial markets: The PFTS index goes down**

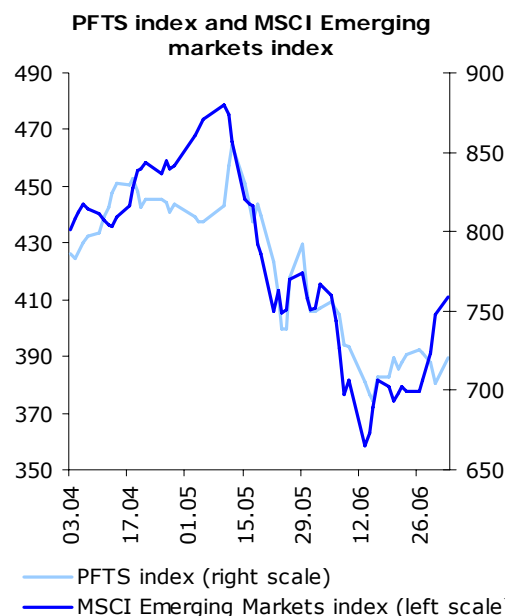
**Stock market.** Stock market in Ukraine took a hit in line with the stock markets of other emerging economies as investors began "flight to quality" due to concerns of rising interest rates and inflation worries in developed economies. After a peak in the first half of May PFTS index lost 19.6% by mid June, although later recouped part of the losses. Other factors influencing index were political uncertainty and negative corporate news. Prospects of political stabilization and improved investment climate might lead to higher stock prices. Nevertheless the lack of liquidity on the stock market might cause considerable fluctuations of the PFTS index.



Source: The State Treasury reports



Source: Derzhkomstat, NBU



Sources: PFTS, MSCI  
 Note: PFTS - First Stock Trading System  
 MSCI - Morgan Stanley Capital Investments



Economic Trends		Q1 05	Q2 05	Q3 05	Q4 05	Q1 06	Feb	Mar	Apr	May	June
GDP growth (real)	% yoy	4.9	3.4	1.4	1.7	...	2.2	4.0	3.5	8.5	...
GDP growth (real)	% yoy cum.	4.9	4.1	3.0	2.6	...	1.5*	2.4*	2.7*	4.0*	...
Industrial production (real)	% yoy cum.	7.1	5.0	3.2	3.1	0.2	-0.6	0.2	0.4	2.4	...
Agricultural production (real)	% yoy cum.	3.9	6.4	3.4	0.0	4.0	3.6	4.0	4.1	4.7	...
CPI	% yoy eop	14.7	14.4	13.9	10.3	8.6	10.7	8.6	7.4	7.3	6.8
PPI	% yoy eop	22.0	17.7	14.7	9.6	6.5	8.1	6.5	5.4	4.8	6.3
Exports (USD)***	% yoy cum.	16.9	10.9	9.0	7.5	-0.3	-5.4"	-4.4"	-3.9"	...	...
Imports (USD)***	% yoy cum.	17.4	21.5	22.3	20.4	24.9	39.6"	30.2"	23.2"	...	...
Merchandise trade balance	USD bn cum.	1.02	0.78	-0.35	-1.14	-1.29	-1.03"	-1.77"	-2.10"	...	...
Current account	USD bn cum.	1.60	2.22	2.63	2.53	-0.74	x	x	x	x	x
Current account	% GDP, cum.	10.1	6.3	4.5	3.0	-4.0	x	x	x	x	x
Gross international reserves	USD bn eop	11.95	13.07	14.26	19.39	17.3	18.3	17.3	17.2	17.7	17.7
Monetary Base	% yoy eop	45.5	38.7	27.2	53.9	25.2	39.4	25.2	24.0	23.9	22.4
Lending rate on UAH credits **	% pa, aop	17.0	15.4	15.4	16.4	15.8	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	5.1	5.1	5.05
Exchange rate (official)	EUR aop	6.95	6.43	6.19	6.00	6.07	6.04	6.07	6.18	6.42	6.4

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 <sup>o</sup>	1.2 <sup>oo</sup>	1.4	3.1	2.9	6.9	2.5
Current account	% GDP	-3.1	2.9 <sup>o</sup>	3.8 <sup>oo</sup>	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 <sup>'''</sup>	% 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

<sup>'''</sup> "Minus" denotes a consolidated fiscal deficit

<sup>o</sup> 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

<sup>oo</sup> 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