



Monthly Economic Monitor Ukraine

- Oleksandr Moroz, the leader of the Socialist Party of Ukraine, was elected as a Speaker of the Parliament.
- In the first half of 2006 real GDP increased by 5.0% yoy.
- In July 2006 new marginal tariffs plan for telecommunication services were approved.
- In May commodity exports grew by 11.4% yoy after six months of continuous decline.
- From January to June central fiscal deficit reached 2.5% of GDP.
- Consumer prices inflation accelerated to 7.4 % yoy in July.
- Accounts of state-owned enterprises will be transferred to state banks, primarily the State Oschadny Bank.

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Politics: Oleksandr Moroz was elected as a Speaker of the Parliament

July 2006 was marked by the severe political turmoil in the Parliament. In the beginning of July the Orange Democratic Coalition, formed by the Block of Yulia Tymoshenko (BYT), the People's Union 'Nasha Ukraina' (NU), the Socialist Party of Ukraine (SPU), was dissolved after the demarche of the SPU. On the July 6, contrary to the signed Coalition agreement, according to which the candidature of the Speaker was supposed to be named by the NU, the SPU nominated its leader Oleksandr Moroz for this position. Mr. Moroz was elected as a Speaker by votes of the SPU, the Party 'Regions of Ukraine' (PR) and the Communist Party of Ukraine. Next day, in contradiction to the Parliament regulations, these three factions announced about the creation of the 'Anti-crisis Coalition'.

The PR leader, Victor Yanukovych, was proposed by the Parliamentary Coalition to the President as a candidature for the position of the Prime Minister. According to the Constitution, the President has 15 days for submitting this candidature to the Parliament. It was not legally clear whether the President could veto the Parliament's nominee.

At the same time, the BYT has demanded the President to dismiss the parliament claiming that the election of the Speaker was done in violation of the Constitution. The major collision is that at the moment there is no effective Constitutional Court in Ukraine, as terms of work of all its judges have expired. Therefore, there is no official interpretation of the Constitutional provisions.

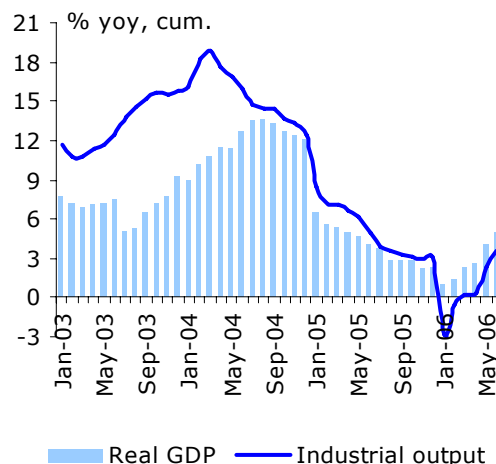
To find the way out of political clinch, on July 27 the President Victor Yushchenko initiated the Round Table with the leaders of all factions, the Speaker and Prime Minister Yuriy Yekhanurov. It was expected that the negotiations would result in a National Unity Pact signed by all parties concerning policies to be conducted by the Parliament and future government. On the August 3, the President, the leaders of the PR, the NU, the SPU, acting Prime Minister and the Speaker signed the Pact. The President has decided to submit the candidature of Mr. Yanukovych to the Parliament as a Prime Minister.

Real economy: Real GDP increased by 5.0% yoy

Despite the political turmoil the real GDP growth continues speeding up. According to the Derzhkomstat, in the first half of 2006 real GDP increased by 5.0% yoy, that is one percentage point above the growth rate in the five months of the year. On the production side, the acceleration is explained by expansion of industrial production stimulated by external demand, as well as higher growth rates of services, in particular wholesale and retail trades and transport. Industrial output increased by 3.6% yoy in the first six months of the year. The key contributors to industrial production growth were machine building, food industry and metallurgy. The latter was recently recovered thanks to higher world metal prices and demand.

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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On the demand side, in the first quarter the major driving force for growth was households' consumption that grew by 19.7% yoy. The second important component of 2006 growth was a recovery of investment activity. In the first quarter the real gross accumulation of fixed capital grew by 8.2% yoy as compared to 2.3% yoy decline in the same period of 2005. Drop in external demand was a key stumbling block for real GDP growth in the first quarter: the real exports of goods and services reduced by 19.9% yoy, while real imports grew by 5.6% yoy allowing to satisfy growing domestic demand. However, exports started to recover in the second quarter, contributing to acceleration of real GDP growth.

Sectoral trends: The government continues increasing tariffs to cost-covering levels

Energy. In July the National Electricity Regulation Commission (NERC) approved plan for electricity households' tariffs adjustment to a cost covering level. According to the plan, households' tariffs are to be increased by 25% each half a year till April 2008. If the Ministry of Justice registers the respective decree of the NERC, the electricity tariffs for households will increase by 25% to UAH 0.24 kW·h from September 1, 2006. This will become the second tariff increase this year, contributing to a higher cost covering, reduction of cross-subsidization in the industry, and improvement of financial viability of energy sector. However, the calculations of the cost covering tariffs and scope of the increases should be more transparent in order to convince the public about the justifiability of tariffs increases.

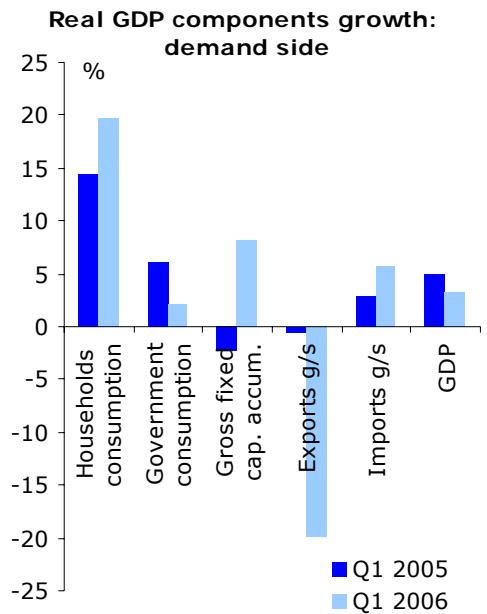
Telecommunication. In July 2006 the National Commission of the Communication Regulation approved new marginal tariffs plan for telecommunication services. According to the plan, domestic fixed line tariffs are to be increased in two stages. On the first stage, from July 15, the fee for usage of fixed line services will be increased by 35% and on the second stage, from November 1, by another 15%. At the same time, international calls will become cheaper thus increasing the competitiveness of Ukrtelecom on this segment of the market. This step allows reducing the cross-subsidization of local calls by international calls. The question of improving quality of Ukrtelecom services remains open.

Privatization. From January to July the State Property Fund collected UAH 160 m of privatization receipts or 8% of annual plan. In July there were announced several relatively big privatization tenders, in particular sale of 76% shares of leading carriage-building enterprise Luganskteplovoy at UAH 292 m starting price. It is likely that selling price will be above this level since there are at least 5 potential bidders for this enterprise. But announced tenders seem insufficient for fulfilling UAH 2 bn privatization plan for 2006.

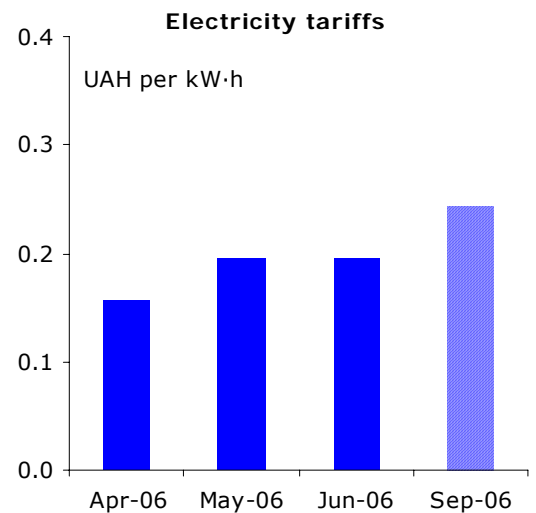
External sector: The exports grew by 11.4% yoy in May

May became the month of changing trend in exports. Thanks to increased world metal prices and demand the monthly exports grew by 11.4% yoy in dollar terms after six months of continuous decline. However, this change has not yet altered the net cumulative figures. According to the Derzhkomstat, in the first five months of 2006 commodity exports declined by 0.9% yoy in dollar terms, while imports grew by 24.4% yoy. As a result, the cumulative commodity trade balance remained negative at USD 2.6 bn compared to positive balance of USD 0.8 bn in the same period of the previous year.

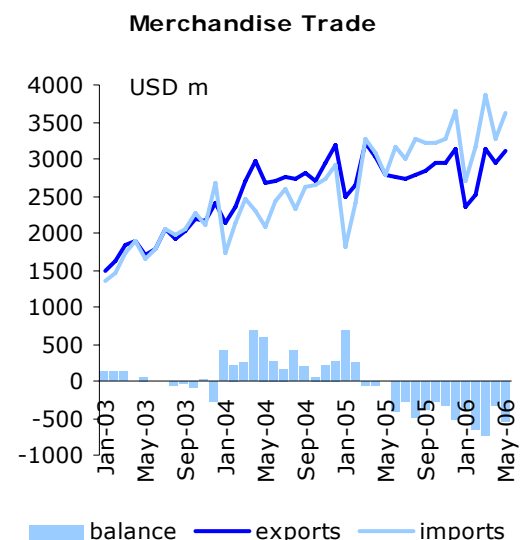
The NBU published the preliminary information on the balance of payments figures in the first half of 2006. As estimated, the current account remained in deficit at USD 0.9 bn or 2.1% of GDP. Commodity exports increased by 1.5% yoy in dollar terms, thanks to the positive trend started in May. The growth of imports was 19.0% yoy. The commodity trade deficit was at USD 2.1 bn. The net inflow of FDI is estimated at high USD 2.3 bn compared to USD 0.6 bn in the same period of 2005 due to investments in construction and transport, as well as purchases of Ukrainian banks by foreigners. Thus, current account deficit was fully financed by FDI.



Source: Derzhkomstat



Source: NERC



Source: Derzhkomstat

Fiscal policy: Central fiscal deficit reached 2.5% of GDP

With a two-month delay the Parliament voted to take into account, though with some suggestions, the Guidelines of the fiscal policy for 2007 prepared by the government. Among other things, the deputies require the Cabinet of Ministers to reincarnate special economic zones and increase customs duties that were reduced in 2005. Furthermore, the Parliament has weakened expenditures cap, which was proposed by the government at 30% of GDP and suggests increasing social expenditures. The Parliament's suggestions revert the vector of the fiscal policy, contradict the strategy of the WTO accession and threaten fiscal and economic stability of the country.

From January to June central fiscal revenues were 2.2% above the target. As before, revenues from VAT and profits of state-owned enterprises are overexecuted by 14% and 25% respectively, while revenues from enterprise profit tax were underexecuted by 13.3%. Central fiscal expenditures were 6% below the target. The resulting central fiscal deficit reached UAH 5.1 bn (2.5% of GDP) and was predominantly financed at the expense of last year privatization receipts accumulated by the Treasury. During June the amount of free funds at the Treasury reduced from UAH 6.1 bn to UAH 4.1 bn.

Social policy: Average monthly pension was UAH 441.8

During first half of 2006 the own revenues of the Pension Fund, received primarily from the contributions paid on wage bills, were 7.1% above the target and totaled to UAH 25 bn. The central fiscal transfer reached UAH 9.5 bn, nearly half of which was transferred for financing deficit of the Pension Fund. As of July 1, average pension was UAH 441.8 per month. It will rise from October, when minimum pension will be increased from UAH 359 to UAH 366. If new Parliament does not increase minimum pension further this year, it is likely that the deficit of the Pension Fund will be in the limits approved by the government at UAH 7.3 bn.

Monetary policy: Inflation accelerated to 7.4 % yoy

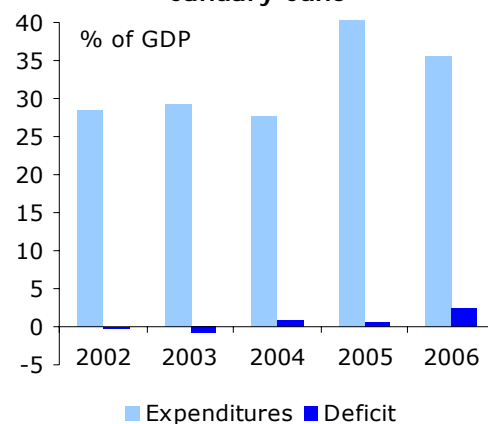
Consumer prices inflation accelerated to 7.4 % yoy in July from 6.8 % yoy in June marking an end to five-month period of deceleration in price growth. Key factor contributing to acceleration of inflation was increase in gas tariffs in July. Price growth was moderated by the effects of continued ban on exports of livestock products to Russia and comparatively low rates of monetary expansion. Increases in administratively regulated tariffs and prices are expected to be the key factors contributing to inflation over next months.

In July, the NBU continued policies aimed at increasing banking liquidity and boosting bank demand for national currency deposits. In particular, the NBU decreased rates for secured and blank overnight credits by 0.5 percentage points to 9.5% and 10.5% respectively and further decreased reserve requirements for commercial bank deposits, contributing to increase in banking liquidity. The reserve requirements for deposits in national currency were decreased more than for equivalent deposits in foreign currency. The latter measure is aimed to decrease dollarisation of the banking system, which, according to the NBU officials, is a long-term goal of the NBU. Monetary base and money supply increased by 23.8% yoy and 39.3 % yoy respectively in July.

Financial markets: Accounts of state-owned enterprises will be transferred to state banks

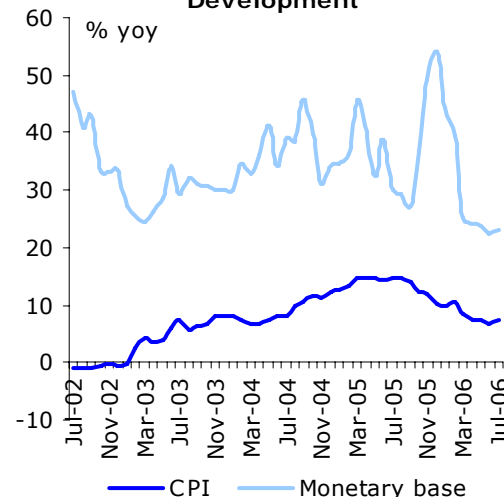
Banking sector. In July the Cabinet of Ministers approved a decision on transferring all accounts of state-owned enterprises from commercial banks to two state banks, primarily State Oschadny bank, with the aim to support the development of state banks. Later this month the Oschadbank was named as an authorized bank for servicing accounts of participants of wholesale electricity market. These decisions should be treated negatively as they will lead to unfair competition between banks and cause a risk that state banks will be involved in quasi-fiscal activities.

Central fiscal execution
January-June



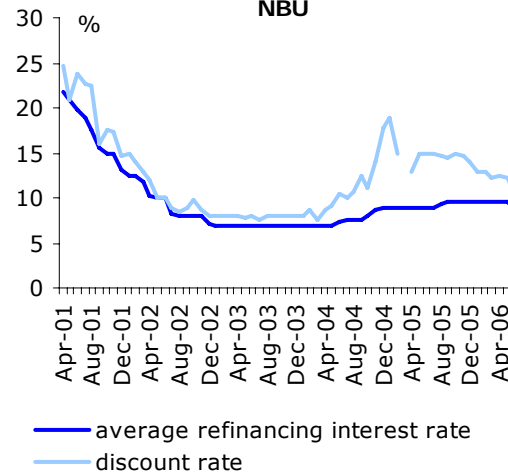
Source: The State Treasury reports

CPI and Monetary Base
Development



Source: Derzhkomstat, NBU

Average refinancing interest
rate and discount rate of the
NBU



Source: NBU



Economic Trends		Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Mar	Apr	May	June	July
GDP growth (real)	% yoy	3.4	1.4	1.7	3.2	...	4.0	3.5	8.5	9.3	...
GDP growth (real)	% yoy cum.	4.1	3.0	2.6	3.2	...	2.4*	2.7*	4.0*	5.0*	...
Industrial production (real)	% yoy cum.	5.0	3.2	3.1	0.2	3.6	0.2	0.4	2.4	3.6	...
Agricultural production (real)	% yoy cum.	6.4	3.4	0.0	4.0	3.2	4.0	4.1	4.7	3.2	...
CPI	% yoy eop	14.4	13.9	10.3	8.6	6.8	8.6	7.4	7.3	6.8	7.4
PPI	% yoy eop	17.7	14.7	9.6	6.5	6.3	6.5	5.4	4.8	6.3	9.4
Exports (USD)***	% yoy cum.	10.9	9.0	7.5	-0.3	...	-4.4"	-3.9"	-0.9"
Imports (USD)***	% yoy cum.	21.5	22.3	20.4	24.9	...	30.2"	23.2"	24.4"
Merchandise trade balance	USD bn cum.	0.78	-0.35	-1.14	-1.29	-2.1 ^e	-1.77"	-2.10"	-2.63"
Current account	USD bn cum.	2.22	2.63	2.53	-0.74	-0.9 ^e	x	x	x	x	x
Current account	% GDP, cum.	6.3	4.5	3.0	-4.0	-2.1 ^e	x	x	x	x	x
Gross international reserves	USD bn eop	13.07	14.26	19.39	17.3	17.7	17.3	17.2	17.7	17.7	18.0
Monetary Base	% yoy eop	38.7	27.2	53.9	25.2	22.4	25.2	24.0	23.9	22.4	23.8
Lending rate on UAH credits **	% pa, aop	15.4	15.4	16.4	15.8	15.5	15.8	15.7	15.3	15.5	15.0
Exchange rate (official)	USD aop	5.10	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05
Exchange rate (official)	EUR aop	6.43	6.19	6.00	6.07	6.34	6.07	6.17	6.45	6.40	6.40

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

^e Preliminary estimate provided by the NBU

^{oo} The value of aircraft complexes transferred to Russia as repayment of a gas debts according to inter-governmental agreement reached in October 1999 totaling USD 274 m is not included.

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