



Monthly Economic Monitor Ukraine

- In August the Parliament elected Victor Yanukovytsch, the leader of the Party of Regions, as the Prime Minister.
- In the first seven months of the year real GDP growth was 5.5% yoy thanks to growth in industry and services.
- The Prime Minister signed a Memorandum of cooperation with representatives of refineries and oil products traders.
- In the first half of the year the commodity trade balance remained negative at USD 2.92 bn.
- Between January and July the central fiscal deficit reached UAH 6.3 bn or 2.5% of GDP.
- Wage arrears reached UAH 1.1 bn by August 1, 2006.
- Inflation remained at 7.4% yoy in August.

**No.9 (71)
September
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: Victor Yanukovytsch was elected as the Prime Minister of Ukraine

The beginning of August 2006 was marked with several important political events. On the August 3, the National Unity Pact was signed by President Viktor Yushchenko, former Prime Minister Yuriy Yekhanurov, and the leaders of four out of five parties and blocs presented in the recently elected Parliament, namely the Party of Regions, the Block "Our Ukraine", the Socialist Party and the Communist Party. The Block of Yulia Tymoshenko rejected to sign the Pact. The Pact stipulates the major principles of internal and external policy of Ukraine.

As agreed, after signing the Pact the President has nominated Victor Yanukovytsch, the leader of the Party of Regions, for the position of the Prime Minister. On the August 4, 271 people's deputies voted for the appointment of Viktor Yanukovytsch and for the new government. The Ministers of Foreign Affairs, Defence, Interior Affairs, Justice, so as Family, Youth and Sports have kept their positions, the first two according to the President's quota. Mykola Azarov once again occupied two positions, the First Prime Minister and the Minister of Finance, as in the previous Yanukovytsch government in 2002-2005.

At the same date, the Parliament finally accepted oath of 14 judges of the Constitutional Court that allows restoring the operations of the Court after more than a half-year forced pause.

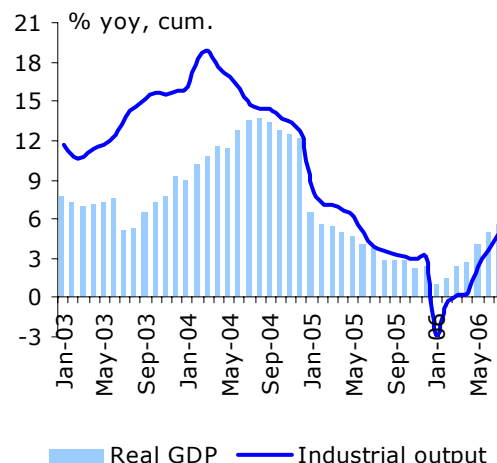
Real economy: Real GDP increased by 5.5% yoy

In the first seven months of the year real GDP growth was 5.5% yoy, continuing accelerating. Increased value added in industry, wholesale and retail trades and transport were the largest contributors to the overall economic growth in the country. At the same time, the value added in agriculture reduced by 1.4% yoy due to lower grain harvest compared to the previous year figure.

Industrial output increased by 4.8% yoy between January and July compared to 3.8% yoy rise in the same period of 2005. Production in manufacturing industry – the largest part of industrial sector – increased by 4.6% yoy thanks to high growth rates of metallurgy and machine building. The increased metal production is attributed to high external demand. However, in August growth of world steel prices decelerated that may hamper the development of Ukrainian metallurgy in the last months of year. High growth rates of machine building – its output grew by 13.1% yoy, first of all due to high growth of transport equipment production – should be attributed to speeded investments as well as increased external demand on Ukrainian machinery and equipment.

Despite political turmoil, in the first half of 2006 investments in fixed capital accelerated to 12.2% yoy compared to 8.5% yoy in the same period of previous year. The highest growth of investments is registered in service sectors, in particular in selected areas of real

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>

estate transactions, in hotels, trade, and transport services. Investments in agriculture increased by 68.1% yoy against the background of around 50% obsolete fixed capital stock. Industrial investments grew by reasonable 11.0% yoy, still accounting for almost 40% of total fixed capital investments. The accelerated investment activity is important for achieving stable growth pace of the economic development of the country.

Sectoral trends: The government signed a memorandum with refineries and oil products traders

Energy. In August Ukraine faced a rise in petroleum products prices by 22% mom, mainly explained by increased world oil prices and seasonal growth in demand for refinery's products. The first reaction of the government was to set a ceiling price for gasoline for a week, which resulted in temporary deficit of gasoline. Then the Cabinet of Ministers (CMU) signed a Memorandum of partnership between the CMU and the companies aimed at creating conditions for sustainable development of oil and oil-products markets, modernization of refineries, and improvement of oil-products quality.

According to the Memorandum, the CMU intends to elaborate a mechanism of creating oil and oil products stocks for alleviating gasoline price fluctuations, to lower railway transportation tariffs for export of crude oil products, to approve some VAT privileges for the refineries, and to revise import duties. In particular, the CMU is going to approve zero tariff on imported equipment used at refineries and abolish zero import duty on oil products, thus increasing the effective rate of protection of domestic producers, which may result in worsening of the production efficiency and quality of products. This Memorandum repeats the same practice used by Viktor Yanukovich government during their previous term. The efficiency of such measure to prevent significant price fluctuations remained questionable. At the same time, promised privileges may reduce efficiency of the economy.

Privatization. In August the State Property Fund has finally published the privatization schedule for the second half of the year. In particular, it is planned to conduct a tender on selling 25% of shares of the National joint-stock insurance company "Oranta" in October. Besides, the schedule foresees the sale of 1.74% of shares of JSC "Mittal Steel Kryviy Rig", which were left in the state ownership. The publication of the privatization schedule is aimed at attracting potential investors to participation in privatization tenders. If fulfilled, these tenders will make the execution of planned privatization receipts for 2006 (at UAH 2.1 bn) more likely.

External sector: Commodity trade deficit was USD 2.9 bn in the first half of the year

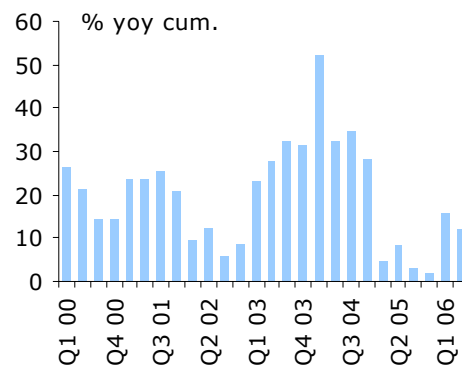
According to the Derzhkomstat, in the first half of 2006 commodity exports increased by 2.1% yoy in dollar terms, while imports grew by 22.1% yoy. The growth of exports indicates the change in the trend, as the five-months figure was still negative. This change was to a large extent attributed to recovery of metal exports in May-June, as well as high growth rates of machinery and equipment exports. The commodity trade balance remained negative at USD 2.92 bn compared to positive USD 0.40 bn in the same period of 2005.

Geographically, Ukraine increased exports to the CIS countries and America and reduced them to Europe and Asia. The reduction occurred mainly due to declined exports of metal and mineral products. However, in May-June exports to Europe returned to growth pace thanks to increased metal demand. In particular, in June exports to Europe grew by 24.1% yoy. The highest growth of imports is observed from Europe and Asia.

Fiscal policy: Central fiscal deficit remained at 2.5% of GDP

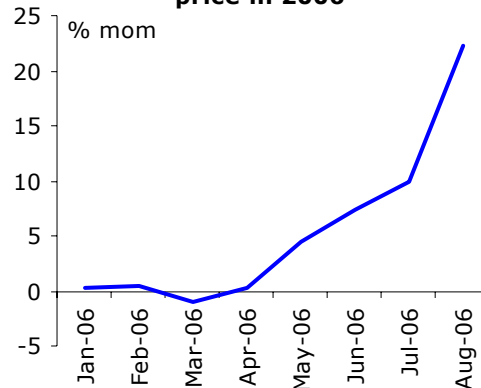
From January to July 2006 the central fiscal revenues were 1.2% above the target thanks to the high VAT revenues over-executed by

Investment in Fixed Capital



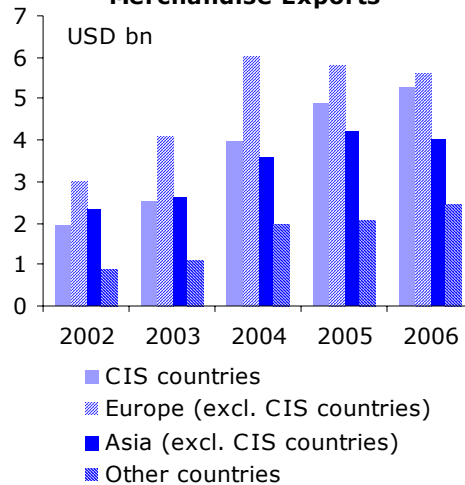
Source: Derzhkomstat

Development of gasoline price in 2006



Source: Derzhkomstat

Regional Distribution of Merchandise Exports*



* data for January -- June of a respective year
Source: Derzhkomstat

UAH 2.8 bn or 13% of projected amount. The high VAT execution was mostly attributed to high imports growth. The over-execution of the VAT allowed compensating the low collection of other taxes, in particular enterprise profit tax, import and exports duties. Despite the acceleration of the economic growth since April, the under-execution of the enterprise profits tax persisted at 15% (UAH 1.8 bn) in January-July. The low enterprise profits tax collection could be attributed to low tax payments by Naftogaz, slow economic growth at the beginning of the year that resulted in lower profits of enterprises, and increased tax avoidance. The poor performance of import duty collection, which was below the target by 14% or UAH 0.4 bn, is explained by over-estimation of import-weighted duty rate used for duty collection projections. The export duty was under-executed by 70% (UAH 0.4 bn) primarily due to the absence of gas re-export. The central fiscal expenditures were executed at 94%. As a result, the central fiscal deficit has reached UAH 6.3 bn or 2.5% GDP. The deficit was predominantly financed at the expense of last year privatization receipts accumulated by the Treasury.

Social policy: Wage arrears reached UAH 1.1 bn

In the first seven months of 2006 real average wage increased by 22.5% yoy. Nominally, the average monthly wage reached UAH 966.9. The growth rates of wages in state administration were the highest, while the industry lagged behind with the real wage growth at 16.7% yoy.

Alongside with the growth of wages from January to July wage arrears increased by 13.4% and reached UAH 1.1 bn by August 1, 2006. Almost 50% of the wage arrears are accumulated in industry, and about 20% in agriculture. The most dramatic growth of arrears is registered in extractive industry, in particular mining, where arrears increased by 27 times and reached UAH 152 m. In August once again the Government transferred fiscal funds to pay these arrears, thus de facto subsidising the mining enterprises and destroying incentives for the efficient work and wage payment discipline.

Monetary policy: Inflation remained at 7.4% yoy in August

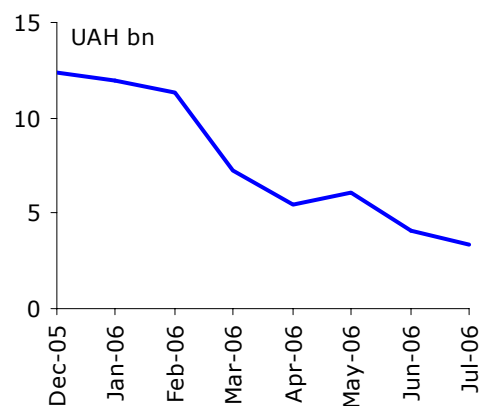
Consumer prices inflation remained at the same level of 7.4% yoy in August as month before. Increases in administratively regulated prices and tariffs were balanced off by the effects of continued ban on exports of livestock products to Russia, favourable dynamics of prices on some of other agricultural products and stable prices on imported consumer goods.

Monetary base and money supply growth decelerated to 19.5% yoy and 37.5% yoy respectively in August compared to 23.8% and 39.2% in July. Deceleration of monetary base expansion was caused by jump in funds of Government deposited in the NBU by more than 20% in August, though purchases of foreign currency by NBU partly offset this effect. Because of looser reserve requirements for commercial banks deposits effective from August 1, 2006 money multiplier increased to 2.77 from 2.70 in July 2006 and 2.41 in August 2005, explaining the faster growth of money supply compared to monetary base.

Financial markets: Exchange rate remains stable

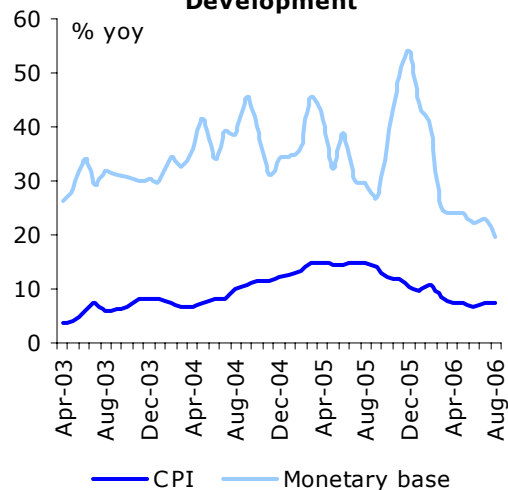
Exchange rate. In August supply of foreign exchange was higher than demand due to increased private spending in summer and positive trends in key export (primarily metal) markets. To support exchange rate stability the NBU intervened in the inter-bank foreign exchange market. As a result, it partially recovered losses of international reserves experienced earlier in the year. International reserves of NBU increased by 3.3% to USD 18.7 bn in August. According to the NBU and the government officials, exchange rate is likely to remain stable with possible slight devaluation in 2007. According to the official forecast for 2007, exchange rate is expected to stay in the range of 4.95-5.25 UAH/USD.

Residual funds at the Treasury accounts (end of period)



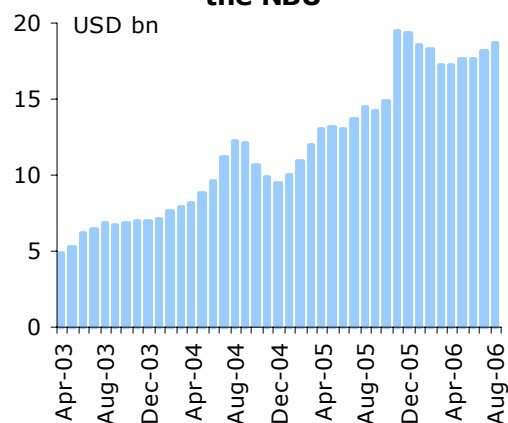
Source: State Treasury

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

International reserves of the NBU



Source: NBU



Economic Trends		Q2 05	Q3 05	Q4 05	Q1 06	Q2 06	Apr	May	Jun	Jul	Aug
GDP growth (real)	% yoy	3.4	1.4	1.7	3.2	...	3.5	8.5	9.3	7.7	...
GDP growth (real)	% yoy cum.	4.1	3.0	2.6	3.2	...	2.7*	4.0*	5.0*	5.5*	...
Industrial production (real)	% yoy cum.	5.0	3.2	3.1	0.2	3.6	0.4	2.4	3.6	4.8	...
Agricultural production (real)	% yoy cum.	6.4	3.4	0.0	4.0	3.2	4.1	4.7	3.2	-1.9	...
CPI	% yoy eop	14.4	13.9	10.3	8.6	6.8	7.4	7.3	6.8	7.4	7.4
PPI	% yoy eop	17.7	14.7	9.6	6.5	6.3	5.4	4.8	6.3	9.4	10.9
Exports (USD)***	% yoy cum.	10.9	9.0	7.5	-0.3	...	-3.9"	-0.9"	2.1"
Imports (USD)***	% yoy cum.	21.5	22.3	20.4	24.9	...	23.2"	24.4"	22.1"
Merchandise trade balance	USD bn cum.	0.78	-0.35	-1.14	-1.29	-2.1 ^e	-2.10"	-2.63"	-2.92"
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	17.2	17.7	17.7	18.0	18.6
Monetary Base	% yoy eop	38.7	27.2	53.9	25.2	22.4	24.0	23.9	22.4	23.8	19.5
Lending rate on UAH credits **	% pa, aop	15.4	15.4	16.4	15.8	15.5	15.7	15.3	15.5	15.0	14.6
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	6.17	6.45	6.40	6.40	6.47

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

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