



# Monthly Economic Monitor Ukraine

- "Our Ukraine" political block moves into opposition.
- Real economic growth accelerates to 6.2% yoy in the first nine months of the year.
- Imported gas price is set at USD 130 per thousand cubic meters at the border in 2007.
- Commodity exports grew 7.9% yoy between January and August, continuing accelerating.
- The Draft State Budget 2007 was approved by Verkhovna Rada in the first reading.
- In October inflation jumped to 11.0% yoy.
- The NBU accumulated USD 19.5 bn of foreign reserves as of the end of October.

No.11 (73)  
November  
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: "Our Ukraine" moves into opposition

In October the block "Our Ukraine" officially announced its move to the opposition to the Government. Thus, tough negotiations on creation of the broad coalition with the existing majority coalition that consists of the Party of Regions, Socialists and Communists failed. After the National Unity Pact was signed in August, "Our Ukraine" faction in the Parliament got four ministerial positions and started negotiations on broad coalition. Another two members of this bloc were proposed to the ministerial positions by the President according to his Constitutional right. The break-out of talks led to recall of the "Our Ukraine" ministers. However, the ministers appointed within the presidential quota did not resign. On November 1, the Verkhovna Rada voted for the resignation of Roman Zvarych, the Minister of Justice, whose position was taken by Oleksandr Lavrinovich, and Ogor Likhoviy, the Minister of Culture, was replaced by Yuriy Bogutskiy. Both of new ministers held these positions in the previous Cabinet of Mr. Yanukovich.

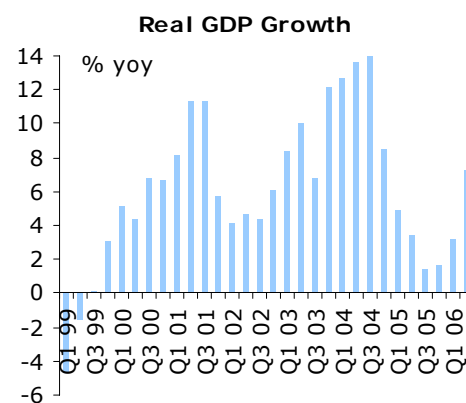
## Real economy: Economic growth further accelerated in the first nine months of the year

Economic growth in Ukraine continues accelerating. According to the Derzhkomstat, in the first nine months of the year real GDP increased by 6.2% yoy. The growth is backed by speeding-up development of industry and services. At the same time, value added in agriculture reduced by 2.3% yoy because of lower grain harvest than a year before.

In October the Derzhkomstat updated the GDP and its component growth estimate for the first half of 2006. The statistical agency revised the figure of real GDP growth upwards by 0.4 percentage points to 5.4% yoy. On production side, the revision included the reduction of the estimated growth rates of industry and transport, but the increased estimate of growth in majority of other services, in particular trade, health care, and education. Such changes are complemented by very strong growth of final households' consumption that increased by record 19.8% yoy and stimulated the development of services. Certain improvement of real exports and increased investments are other two key features of Ukraine's economic development in the first half of the year. It is expected that observed trends will be preserved till the end of 2006.

## Sectoral trends: Imported gas will cost USD 130 per thousand cubic meters at the border in 2007

**Energy.** In 2007 Ukraine will receive up to 62 bn cubic meters (bcm), but no less than 55 bcm of imported gas at a price not higher than USD 130 per thousand cubic meters (tcm) at the border. Such an agreement was signed between RosUkrEnerg and UkrGasEnerg on October 24. That will mean 37% growth in border price for gas for Ukraine. However, this price is still behind prices paid by Ukrainian



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](mailto:institute@ier.kiev.ua)  
<http://www.ier.kiev.ua>

neighbours. Moreover, it seems below the cost incurred by the RosUkrEnerg, making the economic justification of such price dubious. In 2007 RosUkrEnerg plans to buy only Central Asian gas: 49.5 bcm of Turkmen and Uzbek gas at a price of USD 100 per tcm, and 8.5 bcm of Kazakh gas at the undisclosed price. The fee for the transit of this gas through the territory of Russia is USD 38 per tcm. The simple calculation shows that the final price of USD 130 per tcm is economically unjustified. However, according to official statements, the agreement foresees no additional Ukrainian commitments for such a low gas price.

**Public utilities.** From November 1, 2006 the price of gas used by households will be reduced by 22% from UAH 444 per tcm to UAH 345 per tcm for households without gas meters and from UAH 407 per tcm to UAH 315 per tcm for households with gas meters. Such a reduction was achieved by supplying households with domestically extracted gas, the cost of which is lower than the price of imported gas. This decision has negative economic consequences. First, setting price for households lower than the regional average may reduce real economic value of gas for consumers, stimulating inefficient gas consumption. Moreover, selling domestic gas at a low price questions the future development of domestic gas extraction in Ukraine. The protection of poor consumers would be better achieved by targeted assistance, rather than price reduction.

**Privatization.** Between January and September 2006 privatization receipts totalled UAH 0.3 bn, lagging 85% behind the planned for the year UAH 2.1 bn. The Head of the State Property Fund declared that privatization plans would be fulfilled by privatization of the minority share holdings in the several energy companies. It was proposed to sell 5% to 25% stakes with the total market value of UAH 1.4 bn. State will keep more than 60% of shares of afore-mentioned companies. Although the planned renewal of energy privatization is positive step, it seems unfeasible to fulfil privatization plans during last months of 2006.

**Agriculture.** In late September-early October the Government introduced licensing and then quotas on exports of wheat, barley, rye, and corn totalling to 1.6 m tons till the end of the year. This decision effectively stops grain exports in the forth quarter. The introduction of quota is economically wrong decision, as it dampens farm-gate prices thus undermining the financial stance of grain producers, and hurts the international image of Ukraine as a reliable trading and investment partner damaging the investment prospects in the sector.

### External sector: Export growth speeded up to 7.9%

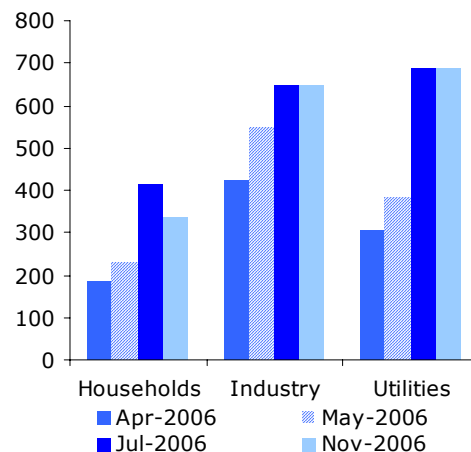
According to the Derzhkomstat, in the first eight months of the year commodity exports grew by 7.9% yoy in dollar terms, thus still lagging behind the imports that increased by 21.2% yoy. The deficit of commodity trade was USD 3.6 bn, slowing its expansion as exports growth speeded up. The key contributors to accelerated exports were metallurgy, machinery and agriculture. However, the introduction of quota on exports of grain in October will halt its exports in the last months of 2006. The major driving force for imports growth was investment demand, with machinery contributing around a half of overall import rise.

According to the preliminary information of the NBU, in the first nine months of the year the deficit of the current account shrunk to USD 0.2 bn compared to USD 0.8 bn in the first half of the year due to speeded exports of goods and services. The inflow of FDI accelerated to USD 3.6 bn between January and September 2006.

### Fiscal policy: Draft State Budget 2007 approved in the first reading

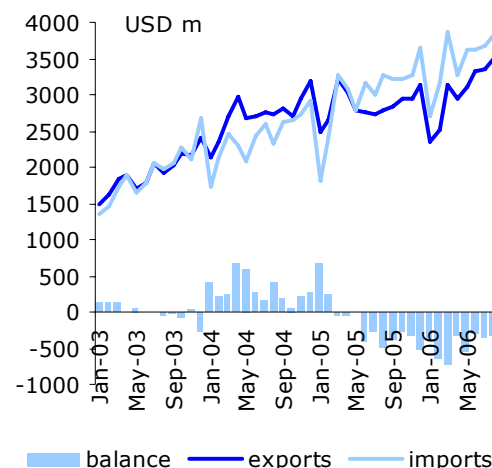
Although with a delay, the Parliament approved the Draft State Budget Law in the first reading. The Parliament also adopted a Resolution, which contained proposed amendments to the draft law. The list of changes includes the increase in revenues via higher

Gas prices for different groups of consumers



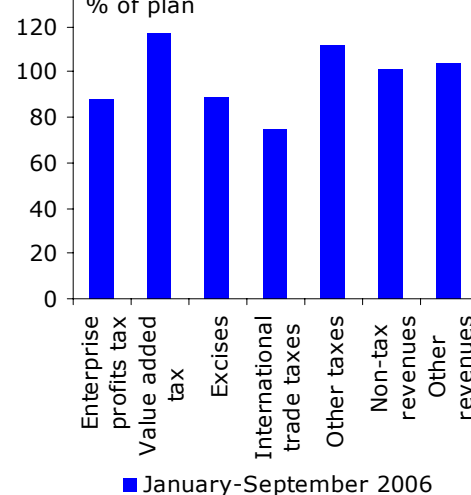
Source: NERC

Merchandise Trade



Source: Derzhkomstat

Central fiscal revenues execution



Source: The State Treasury reports

customs duties and natural resource rents, elimination of planned restrictions on some social payments, and cut in the support of coal industry. The Cabinet of Ministers (CMU) is required to prepare a separate draft law that includes the suggested changes to tax legislation. Furthermore, the CMU should include all the changes to the draft Budget Law proposed by the Parliament and submit the updated version to the Verkhovna Rada till November 20.

Between January and September the central fiscal revenues were 2.3% above the target. The high level of the revenues performance was ensured by high receipts from VAT and custom duties. Also, the execution of revenues was favoured by macroeconomic trends, improved external market conditions, and high tax transfer from the Naftogaz. The expenditures were executed at 96%. The deficit was UAH 4.6 bn or 1.3% of GDP.

### Social policy: Own revenues of the Pension Fund are 7.6% above the target

In the first nine months of 2006 the own revenues of the Pension Fund, received primarily from the contributions paid on wage bill, were 7.6% above the target and totalled UAH 38.8 bn. The central fiscal transfer equalled UAH 13.6 bn, around 44% of which was used for financing the Fund's deficit. In September the average pension was UAH 457.5 per month, 12.7% higher than in January. The average pension will continue growing, as minimum pension was raised from UAH 359 to UAH 366 in October.

It is planned that the Pension Fund runs no deficit in 2007. The central fiscal transfer to the Fund, set at UAH 22.3 bn or 14.5% of total central fiscal expenditures, is assigned for financing pension benefits to military pensioners and retired judges as well as pension benefits according to different state pension programs. Besides, as previously, the Pension Fund is to be compensated the losses caused by lower contributions envisaged by fixed agricultural tax scheme. To boost Pension Fund own revenues, it is planned to increase pension insurance contribution and limit some pension payments. Thus, although central fiscal transfer to the Fund remains high, it has better defined objectives and not caused by the Fund's deficit.

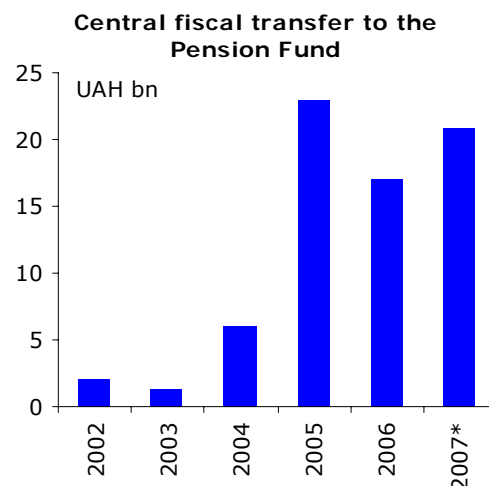
### Monetary policy: Inflation jumped to 11.0% yoy

Consumer inflation moved upwards to 11.0% yoy in October after 9.1% yoy in September. Rapid increase in utility tariffs on regional level and higher food prices contributed to consumer prices increase, which was only partly offset by moderate growth of monetary aggregates, decreased gasoline prices, and continued restrictions on export of dairy and meat products to Russia. Expected lift of aforementioned export restrictions on enterprise-by-enterprise basis, reduction in natural gas tariffs for households effective from November 1, and policy concerning regulated prices will shape inflation development over next several months.

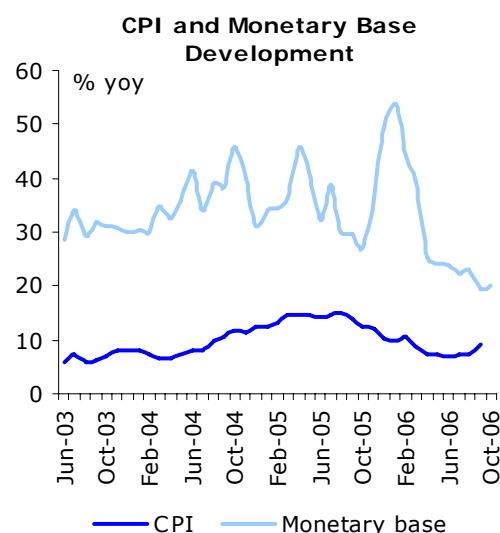
The NBU approved new rules of regulating bank's liquidity effective from November 17. This action reflects the NBU efforts to improve efficiency of interest rate-related monetary policy instruments. New rules include wider access of banks to NBU refinancing facilities, introduction of currency swap as separate instrument of regulating liquidity, and more straightforward framework of standing credit and deposit facilities. Improved regulatory base provides good grounds for more efficient and finely-tuned monetary policy, but question whether available instruments will be actually used remains open.

### Financial markets: The NBU reserves reached USD 19.5 bn by the end of October

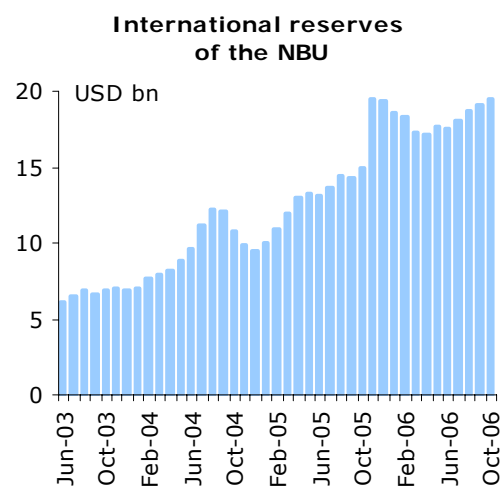
**Foreign exchange market.** As of the end of October the NBU accumulated USD 19.45 bn international reserves, covering 4.5 months of imports. It recouped USD 2.1 bn of reserves lost in the first four months of 2006 due to political uncertainty and trade deficit. Current level provides relatively comfortable cushion that NBU can use to smooth volatility in the exchange rate market.



Source: State Budget Laws for 2002-2006, Draft of the State budget for 2007



source: Derzhcomstat



Source: NBU



| Economic Trends                |             | Q3 05 | Q4 05 | Q1 06 | Q2 06 | Q3 06             | Jun    | Jul    | Aug    | Sep  | Oct  |
|--------------------------------|-------------|-------|-------|-------|-------|-------------------|--------|--------|--------|------|------|
| GDP growth (real)              | % yoy       | 1.4   | 1.7   | 3.2   | 7.3   | ...               | 9.3    | 7.7    | 7.1    | 8.9  | ...  |
| GDP growth (real)              | % yoy cum.  | 3.0   | 2.6   | 3.2   | 5.4   | ...               | 5.0*   | 5.5*   | 5.7*   | 6.2* | ...  |
| Industrial production (real)   | % yoy cum.  | 3.2   | 3.1   | 0.2   | 3.6   | ...               | 3.6    | 4.8    | 5.4    | 5.5  | ...  |
| Agricultural production (real) | % yoy cum.  | 3.4   | 0.0   | 4.0   | 3.2   | ...               | 3.2    | -1.9   | -2.8   | -2.8 | ...  |
| CPI                            | % yoy eop   | 13.9  | 10.3  | 8.6   | 6.8   | 9.1               | 6.8    | 7.4    | 7.4    | 9.1  | 11.0 |
| PPI                            | % yoy eop   | 14.7  | 9.6   | 6.5   | 6.3   | 10.7              | 6.3    | 9.4    | 10.9   | 10.7 | 13.1 |
| Exports (USD)***               | % yoy cum.  | 9.0   | 7.5   | -0.3  | 4.7   | ...               | 2.1"   | 4.8"   | 7.9"   | ...  | ...  |
| Imports (USD)***               | % yoy cum.  | 22.3  | 20.4  | 24.9  | 19.7  | ...               | 22.1"  | 21.3"  | 21.2"  | ...  | ...  |
| Merchandise trade balance      | USD bn cum. | -0.35 | -1.14 | -1.29 | -2.16 | -2.9 <sup>e</sup> | -2.92" | -3.26" | -3.59" | ...  | ...  |
| Current account                | USD bn cum. | 2.63  | 2.53  | -0.74 | -0.78 | -0.2 <sup>e</sup> | x      | x      | x      | x    | x    |
| Current account                | % GDP, cum. | 4.5   | 3.0   | -3.7  | -1.8  | -0.3 <sup>e</sup> | x      | x      | x      | x    | x    |
| Gross international reserves   | USD bn eop  | 14.26 | 19.39 | 17.3  | 17.7  | 19.1              | 17.7   | 18.0   | 18.6   | 19.1 | 19.5 |
| Monetary Base                  | % yoy eop   | 27.2  | 53.9  | 25.2  | 22.4  | 20.3              | 22.4   | 23.8   | 19.5   | 20.3 | 22.5 |
| Lending rate on UAH credits ** | % pa, aop   | 15.4  | 16.4  | 15.8  | 15.5  | 14.6              | 15.5   | 15.0   | 14.6   | 14.6 | 14.3 |
| Exchange rate (official)       | USD aop     | 5.05  | 5.05  | 5.05  | 5.05  | 5.05              | 5.05   | 5.05   | 5.05   | 5.05 | 5.05 |
| Exchange rate (official)       | EUR aop     | 6.19  | 6.00  | 6.07  | 6.34  | 6.43              | 6.40   | 6.40   | 6.47   | 6.43 | 6.37 |

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

<sup>e</sup> 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 <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'''       | % 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

<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    |