



Monthly Economic Monitor Ukraine

- The official results on pre-term elections to the Verkhovna Rada were published on October 27, with two weeks delay.
- Real GDP growth was 7.3% yoy between January and September, relying mostly on high private domestic demand.
- Exports of grain harvested this year will start not earlier than in December due to cumbersome quota administration procedures.
- Between January and September the current account deficit increased to USD 2.5 bn, but was sufficiently covered by high inflows of long-term capital.
- Central fiscal deficit widened to UAH 7.5 bn (1.5% of GDP) in September.
- Inflation accelerated to 14.8% yoy in October.
- The NBU revised the regulations on the costs of external borrowings.

No.11 (85)
November
2007

Population: 46.7 m
Industry/GDP: 26%
Agriculture/GDP: 8%
Investment/GDP: 24%
Exports to: Russia 23%, EU 28%
Imports from: Russia 31%, EU 35%

Politics: Results of pre-term parliamentary elections were published with two weeks delay

On October 27, 2007 the Central Election Commission published the official results of the pre-term elections to the Verkhovna Rada held on September 30. The announcement was delayed by two weeks, as the High Administrative Court was considering the lawsuits contesting the results. The Court rejected the claims and found no evidence of election fraud. Thus, five political forces – Party of Regions, Yuliya Tymoshenko Bloc (BYT), “Our Ukraine - People’s Defence” Bloc (NUNS), Communist Party, and the Lytvyn Bloc – will form the new parliament.

The orange forces – the NUNS and BYT Blocs – signed the coalition agreement, according to which, the leader of NUNS Bloc receives the position of the Speaker, while the leader of BYT becomes the Prime Minister. Also, the spheres of influence are to be divided between the blocs: the NUNS will get power ministries, while the BYT the financial and economic ministries. Though, this coalition includes only 228 members, which is only two persons above the legal minimum. Thus, efficiency and stability of the new coalition remains questionable.

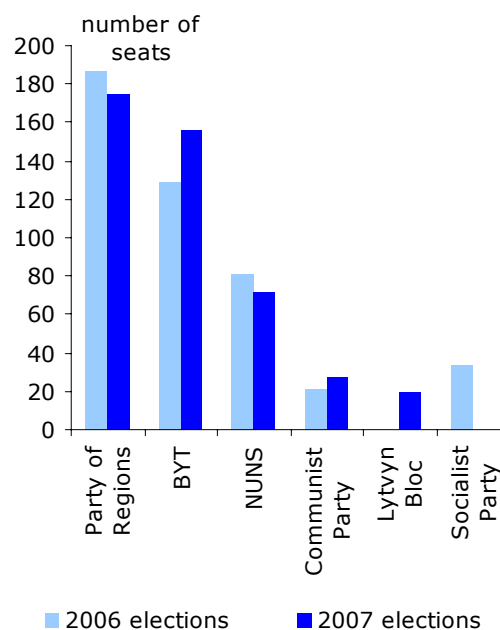
Real economy: Real GDP growth is based on high private domestic demand

In September, real GDP growth continued to slow due to further reduction of value added in agriculture. According to the Dezhkomstat, in the first nine months of the year the real GDP growth was 7.3% yoy, that is 0.2 percentage points below the eight-month growth rate. However, the GDP growth remained higher than it was officially forecasted at the beginning of the year thanks to high private domestic demand.

In the first half of the year, real household consumption increased by 15.1% yoy, fuelled by the growth in real incomes and credit boom. Also, real gross fixed capital accumulation grew by 23.9% yoy, reflecting the expansion of investment activity in the country. Investments are expected to continue boosting stimulated by the acute need to modernize equipment and infrastructure. World financial turmoil doesn’t seem to affect the volumes of Ukraine’s foreign borrowings significantly, though the risk of decelerating investments remains due to higher costs of external and domestic borrowings. On production side, economic growth is based on strong performance of manufacturing, trade, and construction.

Among manufacturing, the major sectors contributing to growth were machine building, metal production, and food industry. Though, the poor harvest and higher prices dampening demand are likely to result in lower food industry growth, contributing to the deceleration of industrial growth which was 10.7% yoy between January and September.

Distribution of seats in the Verkhovna Rada



Source: Central Electoral Commission

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Sectoral trends: Exports of grain harvested this year could be delayed by quota administration procedures

Agriculture. Exports of grain harvested this year could be delayed due to cumbersome quota administration procedures. The new grain quotas came into force on November 1. According to the Ukrainian Agrarian Confederation, it will take more than a month to get a license. In addition, companies will need time to transfer grain from elevators into ports. Therefore, it is impossible to start grain exports earlier than in December 2007.

Privatisation. The last portion of shares (25%+1) of state insurance company "Oranta" was sold in October to the Kazakh bank "TuranAlem". Two Kazakh and one Russian bank were bidding for the lot. The sell-price of the shareholding was UAH 501 m, which is 6.3 times more than the starting price. As a result, the execution of yearly privatisation plan approached 20%. But the abolishment of the tender for Odessa by-port plant announced by the State Property Fund at the end of the month means that the privatisation plan for 2007 will not be fulfilled.

Energy. In early October the Russian "Gazprom" warned to limit gas supply to Ukraine due to USD 1.3 bn debt accumulated by Ukraine. The half of the debt was attributed to "RosUkrEnergO" and "UkrGasEnergO", intermediaries providing gas transit and supply to Ukraine. The rest is actually the debt of Ukrainian consumers, mainly because of low payment discipline by local heating companies. Recently the issue has been resolved, however the conflict may adversely affect the negotiations concerning next year's gas price.

Transport. The Antimonopoly Committee allowed the airline company Aerosvit to acquire control stake (74.99%) of the Donbasaero airline. It is the first deal of such significance on the Ukrainian passenger transportation market. On the one side, it allows two carriers to take more than 50% of the relevant market, which will strengthen their market power. On the other hand, the deal increases the competitiveness and efficiency of Ukrainian airlines, which is vital for the success on the market after the Open Sky Agreement between the EU and Ukraine will be fully implemented.

Infrastructure. The Cabinet of Ministers changed the order on tariff formation on production, transportation and deliveries of heat energy and services of centralized heating. The document foresees the indexation system, which makes tariffs account for changes in input prices. The positive feature of new legislation is the increase in transparency and economic justification of tariff setting. The new scheme also includes provisions for efficiency improvement, which is very important component of the reform. However, the implementation of legislation remains the key issue.

External sector: Current account deficit widened to USD 2.5 bn between January and September 2007

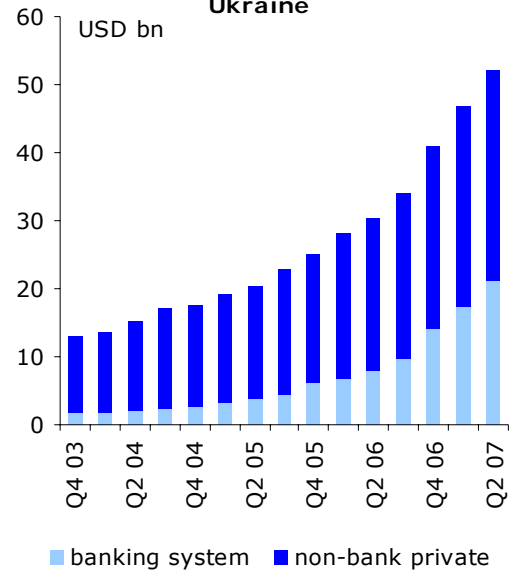
According to NBU preliminary information, the current account deficit increased to USD 2.5 bn (2.6% of GDP) after nine months of 2007. The main reason behind is merchandise imports growing faster than exports, at 31.9% yoy and 27.4% yoy, respectively. Service trade balance increased to USD 1.7 bn, mostly due to tourist inflow. This tendency looks seasonal and is likely to wane in the fourth quarter.

Financial account balance reached USD 10.4 bn mostly due to the inflow of long-term capital, sufficiently covering current account deficit. The inflow of foreign direct investments reached USD 6.8 bn. Also, despite the international financial markets turmoil, external medium- and long-term corporate borrowings spurred in the third quarter, mainly to the active position of real sector companies.

Fiscal policy: Central fiscal deficit reached 1.5% of GDP

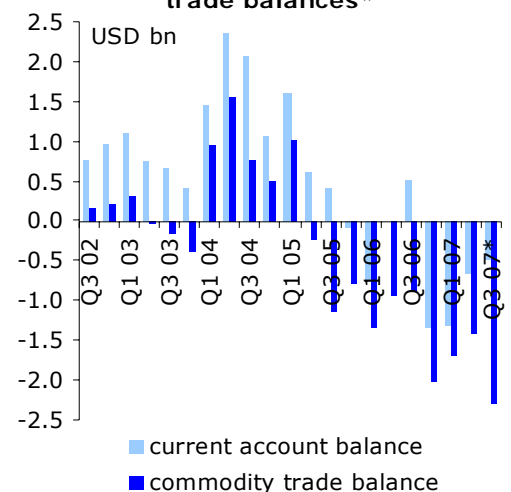
Between January and September 2007 central fiscal revenues were 2.3% above the plan due to high collections from enterprise profit tax. At the same time, the revenues from VAT and excise remained below the target. The execution of central fiscal expenditures

Stock of external private debt of Ukraine



Source: NBU

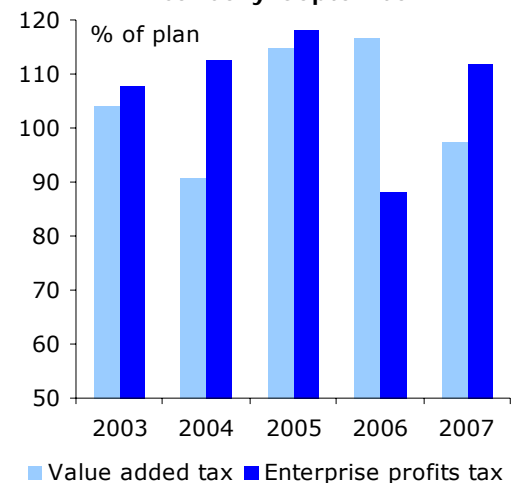
Current account and commodity trade balances*



Source: NBU

* Preliminary estimate by the NBU for Q3 2007

Key tax revenues for January-September



Source: State Treasury, Derzkomstat

reached 95.2%, with social payments, education and public order having the highest execution rate. Central fiscal deficit increased to UAH 7.5 bn, or 1.5% of GDP.

Social policy: Pension payments differentiation increased

According to the Ministry of Labour and Social Policy, between January and October the average monthly pension increased by 30% and reached UAH 590 due to several recalculations of pension payments made by the Pension Fund. The recalculations were stirred by the revision of minimum pension from UAH 380 in January to UAH 415 in October. Thus, the average pension exceeded the minimum one by 42% compared to 25% in 2006, indicating higher differentiation of pensions. The trend is likely to continue in 2008.

According to the Derzhkomstat, in the second quarter of 2007 the unemployment rate (ILO methodology) declined to 7.1% of working able population as compared to 7.4% in the same period of previous year. This trend is mainly attributed to the strong economic growth stimulating labour demand in the country.

Monetary policy: CPI grows to 14.8% yoy in October

Consumer price index accelerated to 14.8% yoy in October as food prices further increased, despite additional administrative pressure on prices. Higher prices were registered for grain and animal husbandry products, as well as vegetables oils.

Both monetary base and money supply grew by 48.5% yoy in October. The growth slowed as the NBU purchases of foreign currency scaled down, and the central bank sharply increased its sales of certificates of deposits trying to reduce bank liquidity and constrain inflation.

Financial markets: The NBU revised the regulation on the cost of external borrowings

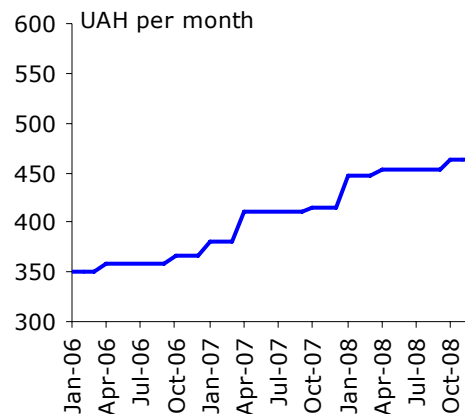
Banking. In October the NBU revised the regulation on the cost of external borrowing, cancelling the planned toughening of capital controls. According to the reformulated regulation effective since January 1, 2008, the cap on the external borrowing cost should be set taking into account average yield on state Eurobonds, average spread between state and corporate Eurobonds, and rating of Ukrainian borrowers assigned by international rating agencies. Though, as the precise mechanism of is not defined, the cap setting remains at the NBU discretion.

Financial standards. The Cabinet of Ministers adopted the Strategy on introduction of international financial reporting standards in Ukraine. The measures implementing EU bookkeeping standards and financial accounts are to be realized between 2007 and 2010. The decision will allow bringing the national rules in accordance with international standards, which should improve investment climate in Ukraine and increase transparency of capital markets.

Stock market. According to the new PFTS rules, the third-level securities were excluded from the listing. As securities in the first and second levels have lower potential for price growth, the rules implementation may decrease income of financial intermediaries; especially pension funds and insurance companies that are limited in purchases of unlisted securities.

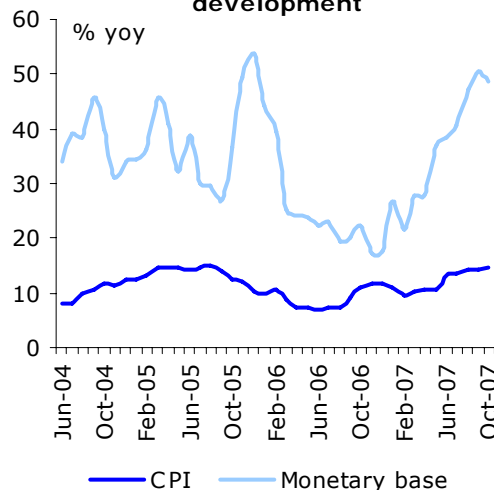
State debt. In October the government continued borrowing on domestic market despite of decreasing demand on state bonds. The Ministry of Finance was able to sell only 4-year bonds at average yield 6.4% and got UAH 150 m, though it planned to attract UAH 600 m selling the bonds with maturity from 3 to 10 years. However, the domestic borrowings are critical to ensure the sufficient financing of the budget deficit. To increase borrowings on domestic market, the government should bring state bonds yield to levels attractive for investors.

Monthly minimum pension



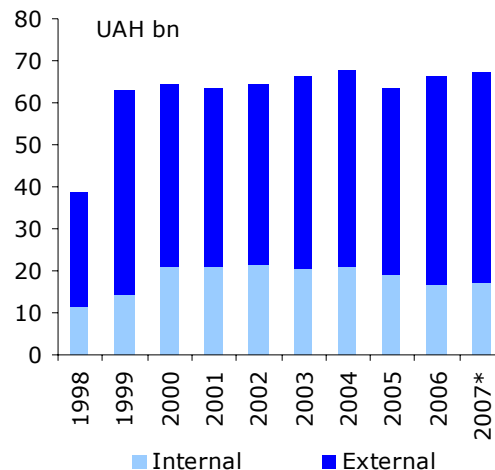
Source: State Budget law for 2006, State Budget Law for 2007, Draft State Budget Law for 2008 submitted to the Verkhovna Rada on September 14, 2007

CPI and monetary base development



Source: Derzhkomstat, NBU

Structure of state debt



Source: Ministry of Finance of Ukraine
Note: * as of October 30, 2007



Economic Trends		Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	Q2 07	Jul	Aug	Sep	Oct
GDP growth (real)	% yoy	4.1	6.8	6.9	9.5	8.0	7.9	7.2	5.8	6.2	...
GDP growth (real)	% yoy cum.	4.1	5.5	6.1	7.1	8.0	8.0	7.7	7.5	7.3	...
Industrial production (real)	% yoy cum.	0.2	3.6	5.5	6.2	12.5	11.8	11.2	10.9	10.7	...
Agricultural production (real)	% yoy cum.	4.0	3.2	-2.8	0.4	5.0	6.3	5.5	-3.4	-5.1	...
CPI	% yoy eop	8.6	6.8	9.1	11.6	10.1	13.0	13.5	14.2	14.4	14.8
PPI	% yoy eop	6.5	6.3	10.7	14.4	17.9	20.6	21.2	20.4	19.6	19.7
Exports (USD)***	% yoy cum.	-0.3	4.7	10.7	13.2	32.4	32.4	31.9"	30.0"
Imports (USD)***	% yoy cum.	24.9	19.7	19.8	22.0	32.0	33.2	35.0"	33.8"
Merchandise trade balance	USD bn cum.	-1.29	-2.16	-2.93	-5.19	-1.75	-3.20	-5.25"	-5.96"
Current account	USD bn cum.	-0.74	-0.78	-0.32	-1.62	-1.31	-2.00	x	x	x	x
Current account	% GDP, cum.	-3.7	-1.8	-0.4	-1.5	-5.0	-3.4	x	x	x	x
Gross international reserves	USD bn eop	17.3	17.7	19.1	22.3	22.9	25.9	27.3	28.9	30.6	31.7
Monetary Base	% yoy eop	25.2	22.4	20.3	17.5	27.7	38.4	40.6	47.2	50.6	48.5
Lending rate on UAH credits **	% pa, aop	15.8	15.5	14.6	15.1	14.0	14.1	13.9	13.3	13.8	13.7
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	6.07	6.34	6.43	6.51	6.62	6.81	6.90	6.87	7.16	7.28

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	2006
Nominal GDP	UAH bn	102.6	130.4	170.1	204.2	225.8	267.3	345.1	441.5	537.7
Nominal GDP	USD bn	41.9	31.6	31.3	38.0	42.4	50.1	65.0	86.2	106.5
GDP growth (real)	% yoy	-1.9	-0.2	5.9	9.2	5.2	9.6	12.1	2.7	7.1
Industrial production	% yoy	-1.0	4.0	13.2	14.2	7.0	15.8	12.5	3.1	6.2
Agricultural production	% yoy	-9.6	-6.9	9.8	10.2	1.2	-11.0	19.7	-0.1	0.4
CPI	% yoy aop	10.6	22.7	28.2	12.0	0.8	5.2	9.0	13.5	9.1
CPI	% yoy eop	20.0	19.2	25.8	6.1	-0.6	8.2	12.3	10.3	11.6
PPI	% yoy aop	13.2	31.5	20.9	8.6	3.1	7.6	20.5	16.7	9.6
PPI	% yoy eop	35.4	15.7	20.8	0.9	5.7	11.1	24.1	9.5	14.1
Exports (gs, USD)	% yoy	-13.4	-7.9	17.9	9.5	10.7	24.0	42.6	7.5	13.2
Imports (gs, USD)	% yoy	-14.0	-19.1	18.9	14.1	4.9	28.7	31.3	20.4	22.0
Current account	USD bn	-1.3	0.9 °	1.2 °°	1.4	3.1	2.9	6.9	2.5	-1.6
Current account	% GDP	-3.1	2.9 °	3.8 °°	3.7	7.6	5.9	10.6	2.9	-1.5
FDI (net)	USD bn	0.7	0.5	0.6	0.8	0.7	1.4	1.7	6.5	5.3
International reserves	USD bn	0.79	1.09	1.48	3.09	4.42	6.94	9.52	19.39	22.26
Fiscal balance'''	% GDP	-2.7	-2.1	-0.7	-1.9	0.8	-0.2	-3.0	-1.9	-0.9
Total state debt	% GDP eop	49.4	61.0	45.3	36.5	33.5	29.0	24.7	17.7	15.0
External state debt (total)	% GDP eop	38.4	49.9	33.0	26.3	24.1	21.4	18.6	13.4	11.9
Monetary base	% yoy eop	21.9	39.3	39.9	37.4	33.6	30.1	34.1	53.9	17.5
Exchange rate	USD aop	2.45	4.13	5.44	5.37	5.33	5.33	5.31	5.12	5.05
Exchange rate	USD eop	3.43	5.07	5.44	5.30	5.33	5.33	5.31	5.05	5.05
Exchange rate	EUR aop	2.77	4.39	5.03	4.81	5.03	6.02	6.62	6.40	6.32
Exchange rate	EUR eop	4.02	5.20	5.10	4.67	5.53	6.66	7.22	5.97	6.65

SOURCES: Derzhkomstat, NBU, IFS, Ministry of Finance, own calculations

''' "Minus" denotes a consolidated fiscal deficit

° 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

°° 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.

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