

Monthly Economic Monitor Ukraine

- The "orange coalition" was formed possessing a tiny majority of 227 seats in 450-member Verkhovna Rada.
- Real GDP growth remained at 7.3% yoy between January and October.
- The introduction of grain export quotas was postponed till December 31 to fill up the state reserve.
- The last bilateral protocols necessary for Ukraine's WTO accession were signed with Kyrgyzstan and Vietnam.
- Central fiscal deficit increased to UAH 9.3 bn (1.7% of GDP) between January and October due to higher execution of expenditures.
- The amended Draft State Budget 2008 envisages further increase in social expenditures.
- The NBU introduced reserve requirement on external borrowings of the banks.

**No.12 (86)
December
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: The future of newly formed 'orange coalition' is questionable

On November 23, the newly elected Verkhovna Rada opened its first session. One week later the coalition of "Our Ukraine – People Self-Defence" and Yuliya Tymoshenko Blocs was formed. However, the coalition negotiations were tough. Initially seven members of "Our Ukraine – People Self-Defence" Bloc refused to sign the agreement. Only after the interference of the President six of them affixed the signatures under the document. The coalition including 227 members, which is only one person more than absolute majority, evoked doubts in its ability to act. Despite this on December 4 Arseniy Yatsenyuk was elected the Speaker with 227 votes. The other parties found such decision acceptable. The election of the Prime Minister is one more check for coalition's integrity.

Real economy: Real GDP growth remained at 7.3% yoy between January and October

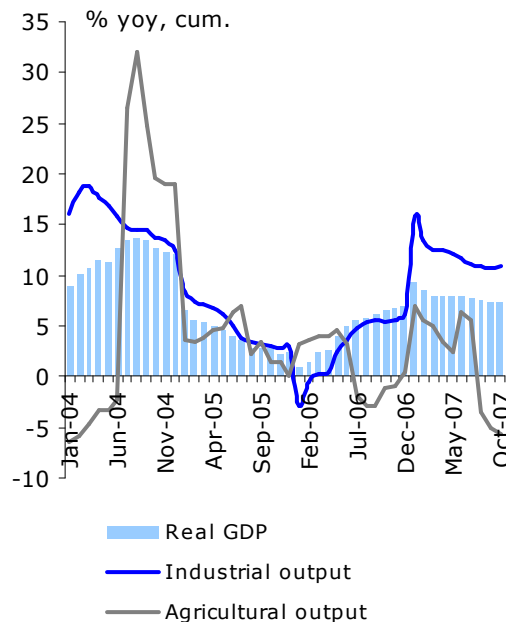
According to the Derzhkomstat, in the first ten months of the year the real GDP increased by 7.3% yoy, thus maintaining the growth rate of the previous period. A further reduction in agriculture value added was counterweighted by higher growth in trade and manufacturing that remained the key contributors to the real GDP expansion. In particular, the production in manufacturing increased by 12.7% yoy, explaining most of the 11.0% yoy industrial output rise between January and October. The fastest growing sector in manufacturing was machine building that increased by 27.4% yoy and contributed around one third to the total industrial output growth. This sector growth is partly attributed to increased domestic investment demand.

In the first nine months of the year investments in fixed capital increased by 28.5% yoy, primarily due to the boost of investments in manufacturing. Likely, this boost is associated with the installation of energy-saving equipment against the background of growing energy prices. Though, the investments in production and distribution of electricity, gas and water – the key providers of infrastructure services – dropped by 15.1% yoy. So far it seems that the efforts of private sector to improve energy efficiency could be mitigated by losses caused by outdated equipment owned by the state.

Sectoral trends: Grain exports will start only in 2008

Agriculture. The introduction of export quotas for grain harvested in 2007 was postponed till December 31. The official justification is a need to fill up the grain reserves, keep bread prices stable, and better analyze world grain market tendencies. The envisaged grain export quotas remained at the level of 1.2 m tons. Such policy

Real growth rates of GDP, industrial and agricultural output



Source: Derzhkomstat

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makes Ukraine unreliable trade partner on the world grain market and creates losses for the Ukrainian economy.

Transport. The Ministry of Transport and Communications (MTCU) banned tariff increase for passenger rail transportation in November as it did earlier in September. The official explanation was that there were no improvements in the quality of service. Though, starting from January 2008 tariffs will be increased by 25% against the level of January 2007. As no dramatic changes in services during two months could be reasonably expected, the explanation could be the Government unwillingness to add up to the inflationary pressure at the end of the year. The issue of transparency in tariffs setting has also remained acute. Unless an independent regulator is created, neither service improvements nor justified tariffs can be expected.

External sector: Last bilateral protocols necessary for WTO accession were finally signed in November

In November Ukraine achieved a significant progress in the WTO membership negotiations, when finally it signed bilateral protocol on access to markets of goods and services with Kyrgyzstan. Also, Ukraine signed a bilateral protocol with Vietnam, the new WTO country-member that joined the Organization and Ukraine's Working Party only in 2007. Several legislative questions have remained open including the unification of railway transportation tariffs for domestic and foreign customers, the reduction of export tariffs, and the development of marking procedures for genetically modified products. The next meeting of the Working Party was scheduled for the end of November, but has been shifted to mid-December. If remained questions are resolved promptly, Ukraine could become the member of the WTO by mid-2008.

According to the Derzhkomstat, between January and September exports of goods and services grew by 25.7% yoy and imports by 31.2% yoy. The resulting trade deficit was USD 3.7 bn compared to the deficit of USD 1.4 bn a year ago. High growth rates of commodity imports resulted in commodity trade deficit of USD 6.7 bn for the first nine months of the year. Service trade balance remained positive at USD 3.0 bn, though growth rates of services exports (15.8% yoy) were lower than those of imports (27.6% yoy).

Fiscal policy: Central fiscal deficit reached 1.7% of GDP

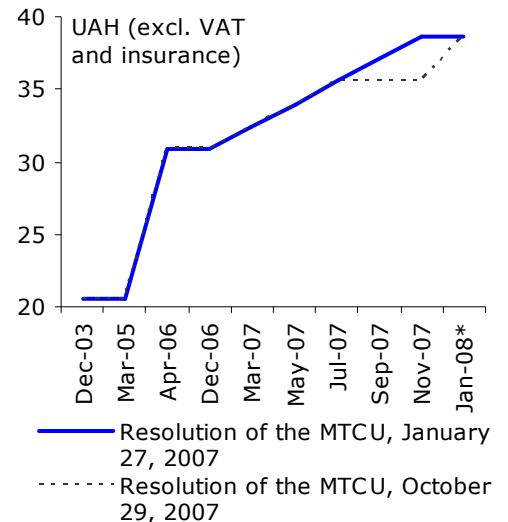
Between January and October 2007, the central fiscal revenues exceeded the target by 2.2% mainly due to higher than planned enterprise profit tax receipts. Besides, extra revenues were received from taxes on international trade, and profits of state-owned enterprises. The revenues from VAT and excises on domestic products remained below the target. Traditionally, as the end of the year approaches, the execution of central fiscal expenditures improved and reached 94.9% of the plan. The resulting fiscal deficit increased to UAH 9.3 bn (1.7% of GDP).

On November 21, the Government approved the updated Draft State Budget for 2008. The changes are mainly attributed to the revision of the macroeconomic forecast. The central fiscal revenues were increased by UAH 19.3 to UAH 206.3 bn, while expenditures were raised by lower amount – UAH 17 bn – to UAH 224.8 bn. As a result, the planned central fiscal deficit was reduced a bit and set at UAH 16.5 bn or 1.9% of GDP forecast for 2008.

Social policy: The draft State Budget 2008 is paying more attention to social issues

According to the revised Draft State Budget for 2008, the major part of additional funds (UAH 16.2 bn) is envisaged for financing higher social payments. The subsistence minimum, minimum wage and minimum pension would be further raised. On the one hand, higher social standards will stimulate growth of income and thus real consumption. On the other hand, they will also increase already high inflationary pressure.

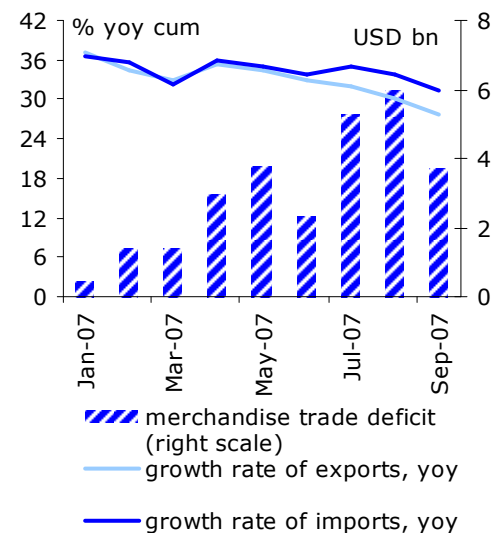
Passenger railway transportation tariffs**



Source: Ministry of Transport and Comm.

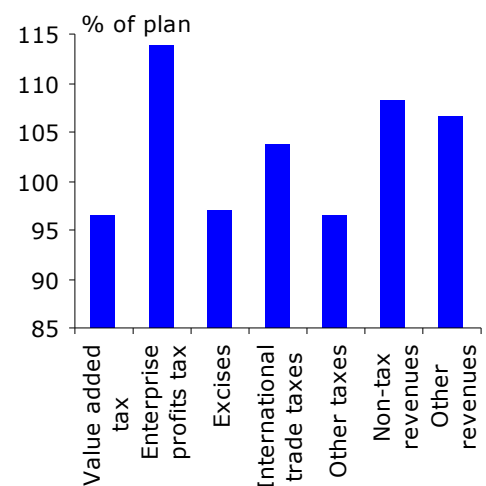
Notes: *planned, **distance = 500 km, passenger train/compartment

Merchandise trade



Source: Derzhkomstat

Central fiscal revenues execution in 2007*



Source: The State Treasury reports

* Between January and October

Besides, the government plans to change the principles of calculating pension payments, increasing the worthiness of seniority (years of insurance record) while assessing pension. This measure is aimed at increasing pension size as well as contributing to higher differentiation of pensions. At the same time, this initiative would create significant pressure on the expenditure side of the Pension Fund budget. Though it is planned with zero deficit, already substantial central fiscal transfer to the Pension Fund is to be increased to UAH 33 bn or 3.7% of GDP forecast for 2008.

Monetary policy: The NBU turns to proactive monetary policy

The NBU introduced a 4% reserve requirement for foreign borrowings by Ukrainian banks, and accelerated issuance of certificates of deposits (CDs) to sterilize foreign exchange interventions. The total effect of these measures is estimated at UAH 7.3 bn, as new reserve requirements increased required reserves of banks by UAH 1.6 bn, and commercial banks invested UAH 5.8 bn in the CDs. This will reduce the volumes of free liquidity and push interest rates up, thus partly limiting inflationary pressure. However, the efficiency of such monetary policy measures by NBU is limited by effectiveness of capital controls as higher domestic interest rates can attract more capital inflows, and willingness of banks to invest in NBU securities.

Inflation in Ukraine accelerated to 15.2% yoy fuelled by high external demand, incomes growth and inflationary expectations, which stimulated demand and influenced pricing decisions by retailers and producers.

Financial markets: The question of financial markets supervision is to be resolved in the Court

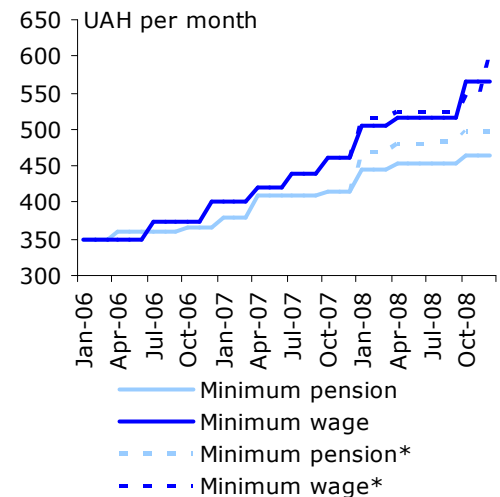
Stock market. In continuation of the conflict regarding the division of powers, the State Commission for Securities and Stock Market was deprived of the status of central body of executive power by the Presidential decree. The document was issued in response to the attempt of the group of deputies to question the right of the President to appoint the members of the Commission. The question is still under revision in the Constitutional Court.

The President also suspended the increase of the statutory fund of the National Depository of Ukraine (NDU) and referred the corresponding documents to the Constitutional Court. The additional issue of shares was claimed unsuitable since it reduces the state share in statutory fund of the NDU, thus hurting economic security of the state. Though, the suspension of the statutory fund increase constrains development of the NDU.

Banking. In November, a group of eight banks introduced KievPrime index calculated on the basis of UAH interbank interest rates submitted by banks-participants every working day. The banks-participants are supposed to provide liquidity within the group on the KievPrime rate, which is likely to be lower than market ones, as far as smaller information asymmetry within the group decreases the risk. Also KievPrime could be used as a benchmark to determine the cost of the loan for non-participants. Such floating index removes the necessity to revise contract terms as market rates change. The launch of the reference rate will foster domestic money market development and give incentives for introduction of derivatives.

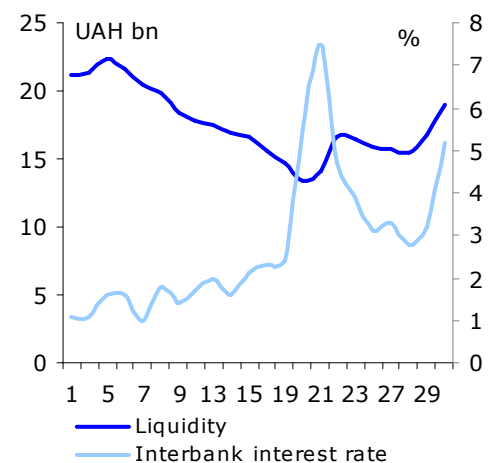
State debt. In November three- and four-year state bonds were sold at the total amount of UAH 819 m with the average-weighted yield of 6.6% p.a. At least half of the issue was bought by state banks. Although this fact may just reflect the willingness of the state banks to improve the asset structure, it may also occur that the practice of the state banks financing fiscal deficit is back.

Monthly minimum pension and minimum wage



* according to the updated Draft State Budget
Source: State Budget Laws for 2006 and 2007, the Draft State Budget Law for 2008 (from September 14, 2007)

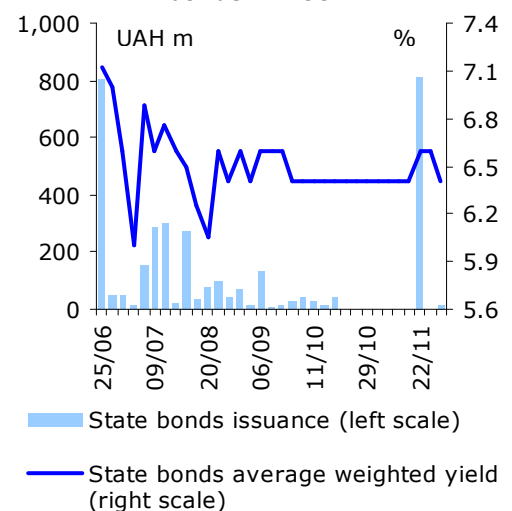
NBU monetary policy in November



Source: NBU

*New reserve requirement in force since November 20

Issuance and average yield of state bonds in 2007



Source: NBU, the Ministry of Finance, IER estimations



Economic Trends		Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	Q2 07	Aug	Sep	Oct	Nov
GDP growth (real)	% yoy	4.1	6.8	6.9	9.5	8.0	7.9	5.8	6.2	7.0	...
GDP growth (real)	% yoy cum.	4.1	5.5	6.1	7.1	8.0	8.0	7.5	7.3	7.3	...
Industrial production (real)	% yoy cum.	0.2	3.6	5.5	6.2	12.5	11.8	10.9	10.7	11.0	...
Agricultural production (real)	% yoy cum.	4.0	3.2	-2.8	0.4	5.0	6.3	-3.4	-5.1	-5.7	...
CPI	% yoy eop	8.6	6.8	9.1	11.6	10.1	13.0	14.2	14.4	14.8	15.2
PPI	% yoy eop	6.5	6.3	10.7	14.4	17.9	20.6	20.4	19.6	19.7	20.0
Exports (USD)***	% yoy cum.	-0.3	4.7	10.7	13.2	32.4	32.4	30.0"	25.7"
Imports (USD)***	% yoy cum.	24.9	19.7	19.8	22.0	32.0	33.2	33.8"	31.2"
Merchandise trade balance	USD bn cum.	-1.29	-2.16	-2.93	-5.19	-1.75	-3.20	-5.96"	-3.71"
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	28.9	30.6	31.7	32.8
Monetary Base	% yoy eop	25.2	22.4	20.3	17.5	27.7	38.4	47.2	50.6	48.5	48.4
Lending rate on UAH credits **	% pa, aop	15.8	15.5	14.6	15.1	14.0	14.1	13.3	13.8	13.7	14.0
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	6.87	7.16	7.28	7.44

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