



Monthly Economic Monitor Ukraine

- The President issued the fourth decree on the dissolution of the Verkhovna Rada.
- Real GDP growth remained at 7.9% yoy during the first half of the year.
- Current account deficit increased to USD 1.9 bn (3.2% of GDP) in the first six months of 2007.
- The subordination of the National Commission for Telecommunications Regulation was changed.
- Central fiscal balance turned into deficit in June and amounted to UAH 2.6 bn (0.9% of GDP).
- The Constitutional Court renewed social privileges postponed by the Law on the State Budget for 2007.
- Inflation accelerated to 13.5% yoy in July.

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Politics: The President signed the fourth decree on Verkhovna Rada dissolution

During July neither the Central Election Commission nor the Constitutional Court made a decision on the legitimacy of the pre-term parliamentary elections. The Constitutional Court started considering the constitutionality of the third presidential decree on dissolution of the Verkhovna Rada, but in the middle of July the judges went on vacation. The attempt of the Parliament's speaker Oleksandr Moroz to call the special session failed as the deputies from the Party of Regions refused to take part in it.

Under these circumstances on July 31 the President issued a fourth decree on dissolution of the Verkhovna Rada to guarantee the pre-term elections. Now, the President grounded the dissolution on the fact that the Verkhovna Rada is not legitimate as it consists of less than two third of its constitutional size, and the size cannot be restored. Early August key political parties have hold their meetings, and presented final election lists.

In July the Cabinet of Ministers approved the Order of the Cabinet of Ministers. According to new order, the Prime Minister and Vice-Prime Ministers strengthen their authorities in policy-making at the expense of ministers. From now on the Government could review only decisions pre-approved by the committee headed by Prime or Vice-Prime Minister. Those changes centralize political power and may stimulate corruption.

Real economy: Real GDP growth remained at 7.9% yoy during the first half of the year

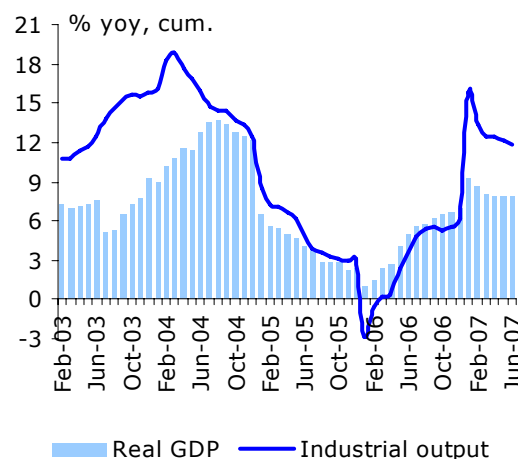
According to the Derzhkomstat, the real GDP growth remained at 7.9% yoy in the first half of the year supported by growth in manufacturing, trade, and construction. A key feature of the economic development in June was a rapid acceleration in the growth of agricultural value added, which occurred after a slowdown in this sector that lasted several months. Between January and June the growth in agricultural value added was 5.7% yoy, compared to 2.3% yoy in the first five months of this year. The major reason was the early harvesting of cereals due to a drought earlier this spring. Thus, the abovementioned tendency is expected to stop soon.

On demand side, major portion of the economic growth was due to high private domestic demand. According to the Derzhkomstat, in the first quarter of 2007 real households consumption increased by 14.7% yoy, thus continuing the expansion started several years ago. The high consumption was stimulated both by stable growth in households' incomes and continued expansion of household credits.

The growth of domestic demand fostered imports of goods and services that grew by 12.9% yoy in real terms and surpassed the growth of exports (4.9%). Gross accumulation of fixed capital grew

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%

GDP and industrial output



Source: Derzhkomstat

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by 24.4% yoy in the first quarter and is expected to follow the trend, stimulated by competition and need to cope with high energy prices.

In the first six months of 2007 industrial output grew at 11.8% yoy. As before, the leading industrial sector was machine building, especially production of vehicles and transportation equipment. The later grew at 30.6% yoy between January and June 2007, which is even higher than a month earlier. The development of the sector is backed by strong demand for investment and durable goods, both in Ukraine and in the rest of the CIS countries.

Sectoral trends: The subordination of the National Commission for Telecommunications Regulation was changed

Telecommunications. The Regulation adopted in July changes the subordination of the National Commission for Telecommunications Regulation. Before the Commission was appointed by the President and coordinated by the Cabinet of Ministers, while now the Government gets the right to appoint the members and the head of the Commission. Thus, the adopted document undermines regulator's independence and creates the prerequisites for the government's interference. At the same time the document contradicts the existing law on telecommunications, which can evoke different interpretation of Commission's powers as well as harm the regulator's efficiency.

Transport. In July two important credit agreements in transport sector were signed. First, the European Investment Bank (EIB) lent EUR 200 m to the State Road Service "Ukravtodor" for the rehabilitation of the M-06 road, the major route between Ukraine and the EU. Second, railways transportation state monopolist "Ukrzaliznytsia" raised a USD 550 m syndicated loan organized by Barclays Capital Bank to refresh rolling stock and finish the construction of the bridge over the Dnipro river. It is hardly disputable that transport infrastructure needs additional funds, but the efficiency of the projects to a great extent depends on how transparent the use of these funds will be.

External sector: Current account deficit widened in the first half of the year

According to the NBU preliminary estimates, in the first half of 2007 current account deficit reached USD 1.9 bn (3.2% GDP) due to negative commodity trade balance of USD 3.1 bn and a reduction in positive service trade balance to USD 0.5 bn.

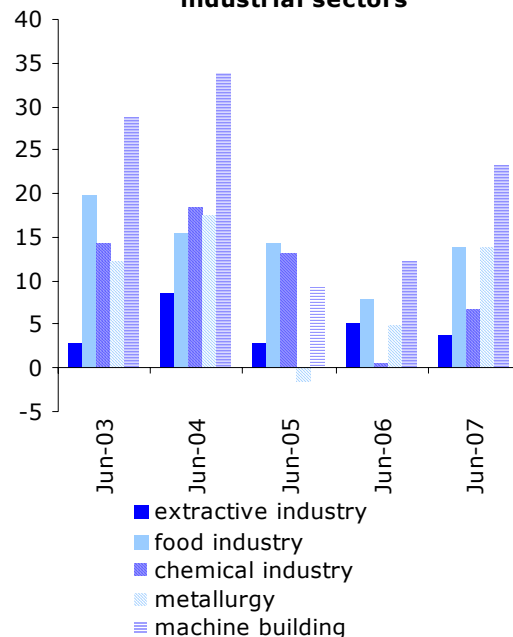
Growth rates of commodity exports and imports were 32.4% yoy and 33.0% yoy in dollar terms, respectively. High growth rates of exports were caused by favourable world metal prices, increased external demand for the Ukrainian machinery, and a renewal of growth in agricultural exports. The latter is explained by grain exports in June, as far as previous quotas were abolished in May, while new one was introduced only since July 1. Growing internal demand stimulated greater imports of machinery and mineral products. Service imports exceeded exports growth (25.2% and 16.9%, accordingly), reducing the respective trade balance.

Nevertheless, the current account deficit still could be treated as sustainable due to the high inflow of long-term resources. Financial account balance reached USD 5.5 bn, which compensated trade deficit along with the increase in international reserves by USD 3.7 bn. Net foreign direct investments inflow amounted to USD 2.7 bn with banking sector remaining as the most attractive niche.

Fiscal policy: Central fiscal balance turned to deficit in June and reached 0.9% of GDP

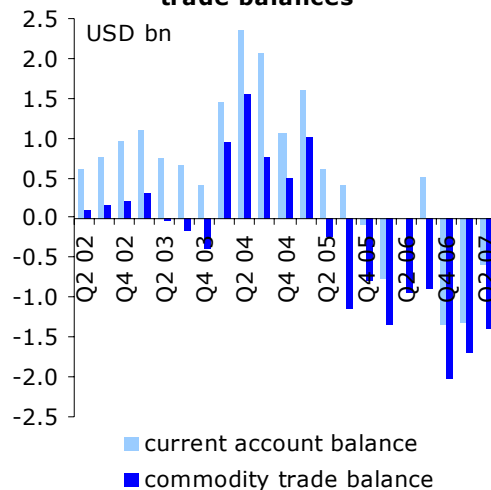
In the first half of 2007 the central fiscal revenues were above the plan by 4.6%. In particular, revenues from enterprise profit tax were by 9.9% above the target due to strong growth of enterprises' profits. As in previous period, the VAT revenues exceeded the plan by 2.7% due to high VAT collections on imports. At the same time,

Growth of output in key industrial sectors



Source: Derzhkomstat

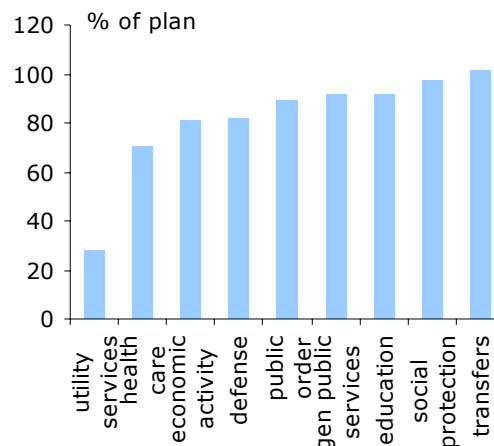
Current account and commodity trade balances*



Source: NBU

* Preliminary estimate by the NBU for Q2 2007

Central fiscal expenditures in the first half 2007



Source: State Treasury
Source: State Treasury

the VAT on domestic production was by 3.6% below the predicted level. The State treasury also received additional revenues from profits of state-owned enterprises that were 86.8% above the planned figure. Central fiscal expenditures increased and reached 92.5% of the plan. As a result, in June a central fiscal balance turned into deficit and reached UAH 2.6 bn or 0.9% of GDP.

Social policy: The Constitutional Court renewed numerous privileges

In July, 2007 the Constitutional Court of Ukraine published its decision on the unconstitutionality of several provisions of the State Budget Law for 2007. It is mostly about the articles that cancelled privileges for public sector employees and military personnel, reduced payments to war veterans, restricted pension payments of those under the retirement age, etc. This decision renewed numerous privileges, which were suspended for 2007 by the State Budget Law. According to the government estimations, the implementation of the Constitutional Court's decision would require UAH 70 bn (44.5% of the central fiscal revenues in 2007) that makes the execution of the decision *de-facto* impossible. The collision reveals deeper problem of unreformed social welfare system that provides too many privileges, frequently poorly targeted. It is necessary to reform the system by introducing a targeted aid and reducing bureaucratic procedures associated with it.

Monetary policy: Inflation reached 13.5% yoy in July

Inflation in July only slightly accelerated up to 13.5% yoy as major shift in prices for seasonal products was already incorporated in June, prices for bread were controlled, and prices for petrol remained stable.

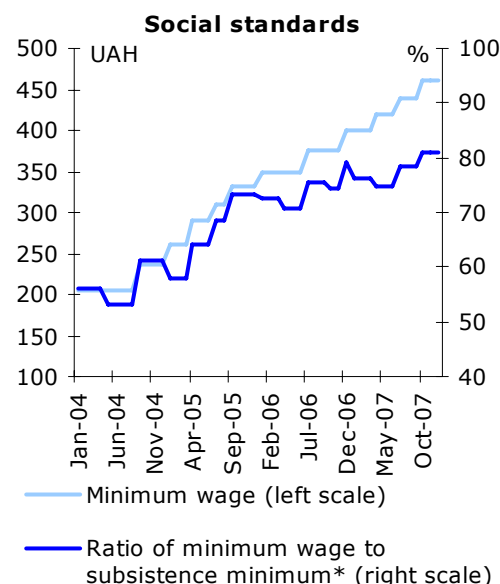
Monetary base has grown by 40.6% yoy in July and money supply increased by 43.2% yoy as long as the inflow of foreign capital remained high and the NBU continued buying foreign exchange on inter-bank market. In July the NBU's foreign reserves increased by USD 1.1 bn and reached USD 27.3 bn. The inflow of foreign capital is expected to continue putting more pressure on the exchange rate.

Financial Markets: Foreigners acquiring Ukrainian stock exchange

Stock market. The Antimonopoly Committee allowed the Russian Stock Exchange RTS to purchase stocks of the Ukrainian stock exchange "Innex". Now the lion's share of securities trade in Ukraine takes place on PFTS. Therefore, the Russian entry could be considered as a strategic one. The deal demonstrates increasing interest of foreign investors in Ukrainian stock market. Entry of the Russian stock exchange promises improvement in market liquidity due to development of new trading technologies, such as on-line trading, supply against payment systems, etc.

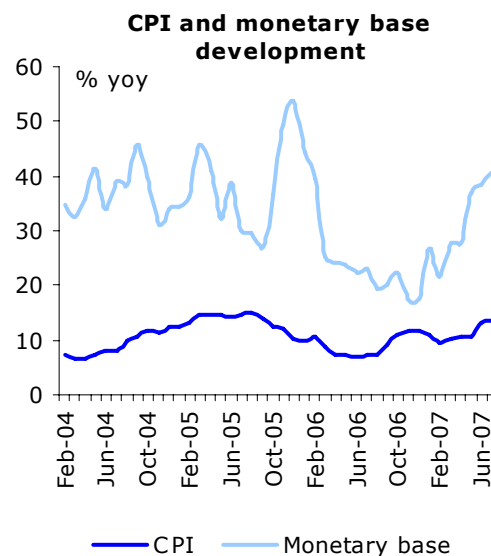
Banking sector. According to the NBU, in the first half of the year total assets of the banking system grew by 72.9% yoy mainly due to an increase in credit volumes. At the same time, the share of consumer loans in total credits decreases, which shows growing interest of the banking sector in business credits that should have a positive impact on real economy.

State debt. In July the Ministry of Finance continued borrowing on the domestic market. During the month four placements took place for the total amount of UAH 1.3 bn, which is 35.0% of the annual plan for domestic borrowings. Securities with the maturity of 1.5-4 years were sold with the yield of 6.5%-7.0%. There is a growing demand for state bonds on domestic market. If June three-year securities with 7.7% yield were not in demand, in July they were placed at 6.5%-6.6% yield. The demand could be partially attributed to expectation of hryvnia revaluation against the background of strong capital inflow, as well as to interest of banks in bonds for refinancing loans.



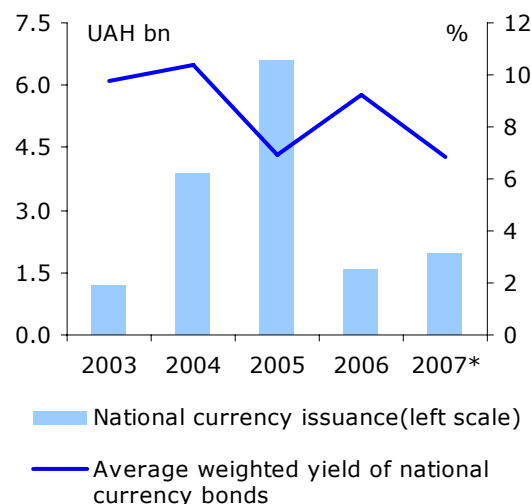
Source: legislation of Ukraine

* Subsistence minimum for working able persons



Source: Derzhcomstat, NBU

Issuance and average yield of state bonds in national currency



Source: NBU, the Ministry of Finance, IER estimations

* on August 01, 2007



Economic Trends		Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	Q2 07	Apr	May	Jun	Jul
GDP growth (real)	% yoy	4.1	6.8	6.9	9.5	8.0	...	7.6	7.7	7.8	...
GDP growth (real)	% yoy cum.	4.1	5.5	6.1	7.1	8.0	...	7.9	7.9	7.9	...
Industrial production (real)	% yoy cum.	0.2	3.6	5.5	6.2	12.5	...	12.5	12.1	11.8	...
Agricultural production (real)	% yoy cum.	4.0	3.2	-2.8	0.4	5.0	...	3.4	2.4	6.3	...
CPI	% yoy eop	8.6	6.8	9.1	11.6	10.1	13.0	10.5	10.6	13.0	13.5
PPI	% yoy eop	6.5	6.3	10.7	14.4	17.9	20.6	18.7	20.2	20.6	21.2
Exports (USD)***	% yoy cum.	-0.3	4.7	10.7	13.2	32.4	32.4 ^e	35.3"	34.4"
Imports (USD)***	% yoy cum.	24.9	19.7	19.8	22.0	32.0	33.0 ^e	35.9"	35.0"
Merchandise trade balance	USD bn cum.	-1.29	-2.16	-2.93	-5.19	-1.75	-3.10 ^e	-2.98"	-3.75"
Current account	USD bn cum.	-0.74	-0.78	-0.32	-1.62	-1.31	-1.90 ^e	x	x	x	x
Current account	% GDP, cum.	-3.7	-1.8	-0.4	-1.5	-5.0	-3.2 ^e	x	x	x	x
Gross international reserves	USD bn eop	17.3	17.7	19.1	22.3	22.9	25.9	23.5	24.7	25.9	27.3
Monetary Base	% yoy eop	25.2	22.4	20.3	17.5	27.7	38.4	27.7	36.9	38.4	40.6
Lending rate on UAH credits **	% pa, aop	15.8	15.5	14.6	15.1	14.0	14.1	14.1	13.4	14.1	13.9
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	6.81	6.83	6.77	6,90

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	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 ^o	1.2 ^{oo}	1.4	3.1	2.9	6.9	2.5	-1.6
Current account	% GDP	-3.1	2.9 ^o	3.8 ^{oo}	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

^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.

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