



# Monthly Economic Monitor Ukraine

- Parliamentary election campaign is going forward.
- Real GDP grew at 7.7% yoy between January and July backed by still high agricultural growth.
- The subordination of the National Commission on Communication Regulation remains unclear.
- According to the Derzhkomstat, the positive service trade balance started to shrink due to lower volumes of gas transit through Ukraine.
- In July the central fiscal deficit increased to 1.2% of GDP.
- Although reduced, unemployment is still more widespread among females, youth, and rural population.
- The NBU tries to impose new capital controls.
- Inflation accelerated to 14.2% yoy in August.

**No.9 (83)  
September  
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: Election campaign is gaining a momentum

On September 2 the Central Election Commission (CEC) finished the registration of political parties and blocs for the parliamentary elections. A total of 21 political forces were registered to take part in the preterm elections on September 30.

According to the polls, four parties and blocs are most likely to be presented in a new Parliament: the pro-government Party of Regions, the opposition Yuliya Tymoshenko Bloc, the pro-presidential Our Ukraine-People's Self-Defence bloc, and the Communist Party. Other parties that may get around 3% threshold are Volodymyr Lytvyn bloc and Socialist party. While the first one has the chance to enter the Parliament, the second one could be the only party to lose its current place in Verkhovna Rada due to the pre-elections.

In August the CEC worked quite successfully on the technical preparations to the elections, in particular formed all territorial election commissions. However, when deciding on some non-technical issues the CEC showed its partisan nature, where votes were evenly distributed among members appointed from coalition and opposition sides. Therefore elections can easily come to standstill in case of any controversy.

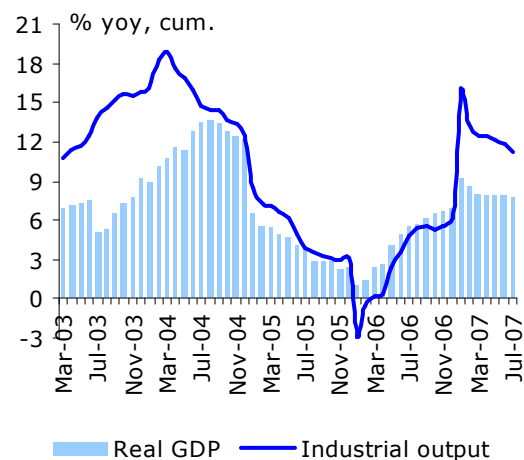
## Real economy: Real GDP grew at 7.7% yoy between January and July 2007

According to the Derzhkomstat, the real GDP grew at 7.7% yoy between January and July. Manufacturing, trade, and construction retained the highest rates of growth. The revival of the agricultural growth that started in June remained in July also. However, it is expected to cease later this year, as most of the growth is primarily due to early harvesting season of crops. On the demand side, high private domestic demand continued to account for the most of economic growth.

In the first half of 2007 investments in fixed capital increased by 32.2% yoy compared to 12.2% yoy in the first half of 2006. According to the Derzhkomstat, more than one third of all investments were directed to industry, real estate transactions accounted for one fifth of the total amount, while investments in transport and telecommunications were 16.6% of the total. The acceleration of investment activity should be attributed to the need for resource-saving technologies, as well as the booming interest in housing market.

In the first seven months of 2007 industrial output grew at 11.2% yoy. Production of vehicles and transportation equipment continued rapid expansion (31.2% yoy), showing the highest rate of growth among all industrial sectors. The development of the sector is stimulated by a strong demand for durable goods, both in Ukraine and in other CIS countries. High construction activity promotes growth in production of construction materials and woodwork

**GDP and industrial output**



Source: Derzhkomstat

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production. The extraction of fuel and energy resources continued declining due to increased imports of high quality coal.

### Sectoral trends: The subordination of the National Commission on Communication Regulation is still unclear

**Telecommunications.** The regulations on the National Commission for Communications Regulation of Ukraine (NCRC) adopted in July were suspended by the Decree of the President. Thus, the changes in subordination of the Commission did not come into force, and the legal position of the regulator is still unclear. This uncertainty hurts the development of the telecommunications sector.

On August 1, 2007 the Cabinet of Ministers allowed attracting the funds for frequencies conversion by inclusion of such costs into the price of the license for 3G. Main mobile operators have agreed to buy licenses under such conditions. The NCRC planned to prepare tender terms and references till the end of 2007. The actions of the Commission demonstrate intention to distribute scarce frequencies in a proper manner. Further growth of mobile market could be fostered if the position of the regulator itself was clarified.

**Privatization.** On August 15 the State Property Fund (SPF) offered for sale 99.52% of Odessa by-port plant. The new owner would have to invest UAH 1.2 bn and increase the revenues to UAH 2.57 bn. The initial price of the plant is set at UAH 2.5 bn, and the SPFU expects to get UAH 10 bn for it, thus fulfilling the privatization plan for 2007 (UAH 10.5 bn).

An auction is expected to take place on October 29. There are already 4 Ukrainian and 2 Russian companies, expressed their interest in the company. However, the President suggested forbidding the sale of the plant. He argues that one of the largest and strategically important objects cannot be sold in terms of political instability. This situation once again demonstrated the absence of clearly defined privatization policy in the country.

### External sector: The positive balance of trade in services is shrinking due to reduction of gas transit

According to the Derzhkomstat, in the first half of 2007 exports of goods and services grew by 28.6% yoy and imports by 32.9% yoy. Trade deficit was USD 2.3 bn, that is 1.2 times more than a year before. The deficit expansion is explained both by a growth of the negative balance of commodity trade that reached USD 4.2 bn, and reduction of the service trade balance.

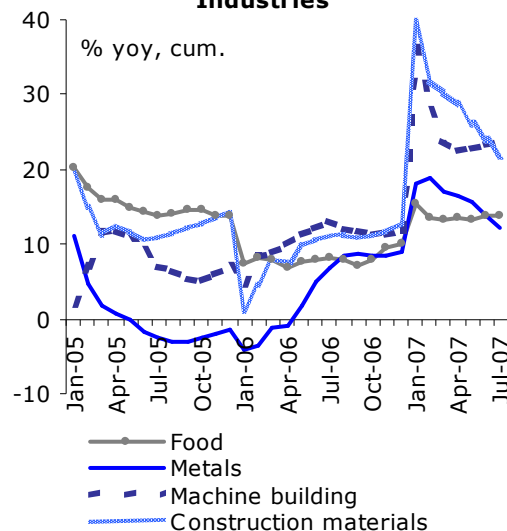
Service exports grew by 8.0% yoy, while service imports increased by 22.0% yoy. As a result, the service trade balance somewhat shrank, although remained positive at USD 1.8 bn. The deceleration of service exports could be explained by lower volumes of gas transit through Ukraine due to warm winter. At the same time, the exports of non-transport services, especially financial and other business activities, as well as tourism, continues to grow steadily. However, imports of such services are higher than exports. Thus, unless the exports of transport services restore, Ukraine is likely to face a deficit of service trade quite soon.

Exports of goods and services to the CIS countries increased by 44.6% yoy, and to the rest of the world by 20.6% yoy. The trend is observed mostly due to significant acceleration of commodity exports to Russian Federation. The main tradable items were products of machine building, especially transport equipment, and mineral products. At the same time, service exports to the CIS reduced, alongside with the decline in gas transit service exports.

### Fiscal policy: Central fiscal deficit reached 1.2% of GDP

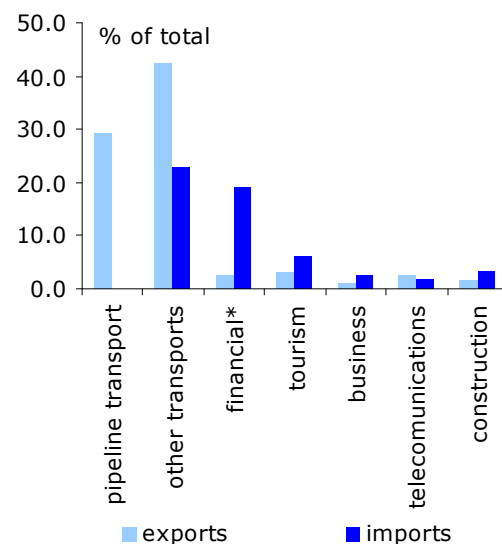
Between January and July, the central fiscal revenues were 4.0% above the plan. The main tendencies remained the same. Revenues from enterprise profit tax exceeded the target by 9.2% due to continued growth. The VAT on domestic production was

### Growth of Output in Selected Industries



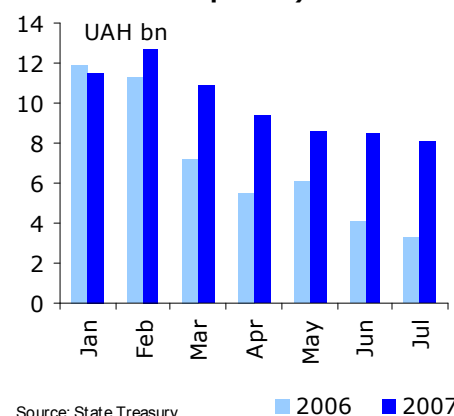
Source: Derzhkomstat

### Foreign trade in major services



Source: Derzhkomstat  
\*including insurance

### Residual funds at the Treasury accounts (end of period)



Source: State Treasury

underperformed, but high collections from VAT on imports allowed total VAT revenues to exceed the target by 1.4%. The central fiscal expenditures were executed at 93.1%. In July the central fiscal deficit increased to UAH 4.3 bn (1.2% GDP). The deficit was financed mainly by funds accumulated on treasury accounts.

### Social policy: The economic growth stimulates the reduction of unemployment and the growth of real wages

According to the Derzhkomstat, in the first quarter of 2007 the level of unemployment, estimated using the International Labour Organisation methodology, was 8.0% of able to work population, which is 0.5% less than in the corresponding quarter of 2006. If the economic growth continues, further reduction of the unemployment could be expected. The level of registered unemployment follows the general trend. In the first quarter it was 3.9% of able to work population, which is 0.5% lower than in the corresponding period of 2006. The structure of registered unemployment is biased towards females (more than a half of registered unemployed) and young people below 35 years old. Also, despite the reduction in unemployment in rural areas, it is still higher than in urban ones.

According to the Derzhkomstat, average wage has been constantly growing. While in January average monthly wage was 1112 UAH, it reached 1368 UAH in June. With the current rate of inflation this yielded growth in real wages of 12.0% yoy, supporting a high growth in real household incomes. Education, health care, public administration and agriculture account for a major portion of the growth, as they experienced the highest rates of growth in wages and comprise over 35% of all workers.

### Monetary policy: Inflation accelerated to 14.2% yoy

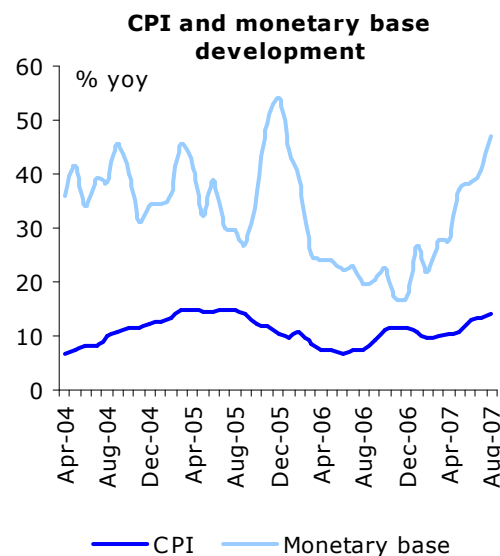
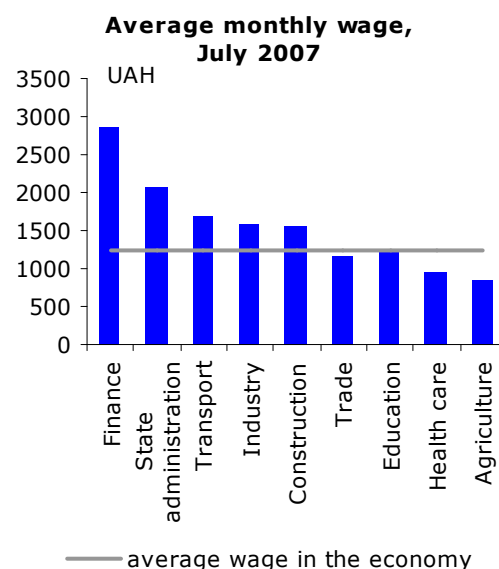
Inflation accelerated to 14.2% yoy in August as prices for livestock products continued to grow due to higher feedstock costs. Still, prices for agricultural products remained constrained by the state regulation, while prices for vegetable and fruit prices exhibited seasonal decreases, restraining overall price growth. However, the state policy of prices regulation increases probability of the price jumps after the end of election campaign.

Monetary base expanded by 47.2% yoy and money supply grew by 45.3% yoy as NBU continued buying foreign exchange on inter-bank market. However, growth of money aggregates may slow down as capital inflows may shrink due to turmoil in the global financial markets and possible capital controls imposed by the NBU.

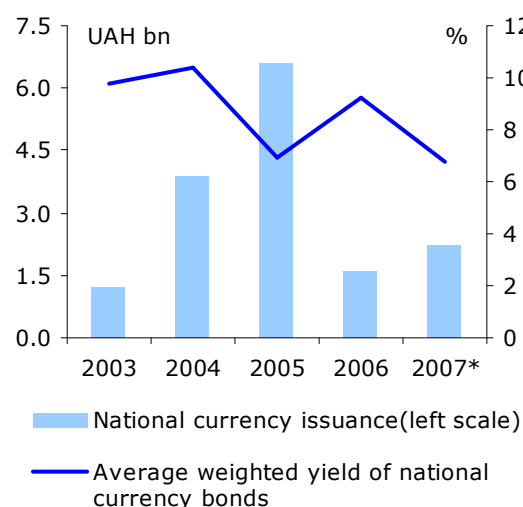
### Financial Markets: NBU tries to impose new capital controls

**Banking sector.** According to the new rules coming into force on October 19, the upper threshold for the yield of foreign borrowings is set as weighted yield on state Eurobonds plus 2 p.p, which now constitutes 8.2%. Such measures may restrict the access to the external borrowings as far as only few companies could attract funds at such low rates. The document allows revision of the loan conditions if the credit is strategically important for the economy. If introduced new rules will cause banks to attract resources on the internal market, thus leading to competition for the deposits and increasing the interest rates. Those rules are strongly opposed by banks and likely to be softened before application.

**State debt.** In August the Ministry of Finance continued borrowing on the domestic market. The bonds with maturity 3-4 years were sold on the total amount of UAH 110 m. The bond yield was increased to 6.6% and 6.4% for the three- and four-year bonds accordingly. However for the longer term state bonds the yield was still unattractive at 5.0%-5.1%. Thus, the government confirms its strategy towards cheap borrowings preferring to attract the funds gradually.



### Issuance and average yield of state bonds in national currency





<b>Economic Trends</b>		<b>Q1 06</b>	<b>Q2 06</b>	<b>Q3 06</b>	<b>Q4 06</b>	<b>Q1 07</b>	<b>Q2 07</b>	<b>May</b>	<b>Jun</b>	<b>Jul</b>	<b>Aug</b>
GDP growth (real)	% yoy	4.1	6.8	6.9	9.5	8.0	...	7.7	7.8	7.2	...
GDP growth (real)	% yoy cum.	4.1	5.5	6.1	7.1	8.0	...	7.9	7.9	7.7	...
Industrial production (real)	% yoy cum.	0.2	3.6	5.5	6.2	12.5	...	12.1	11.8	11.2	...
Agricultural production (real)	% yoy cum.	4.0	3.2	-2.8	0.4	5.0	...	2.4	6.3	5.5	...
CPI	% yoy eop	8.6	6.8	9.1	11.6	10.1	13.0	10.6	13.0	13.5	14.2
PPI	% yoy eop	6.5	6.3	10.7	14.4	17.9	20.6	20.2	20.6	21.2	20.4
Exports (USD)***	% yoy cum.	-0.3	4.7	10.7	13.2	32.4	32.4 <sup>e</sup>	34.4"	32.9"	...	...
Imports (USD)***	% yoy cum.	24.9	19.7	19.8	22.0	32.0	33.0 <sup>e</sup>	35.0"	33.8"	...	...
Merchandise trade balance	USD bn cum.	-1.29	-2.16	-2.93	-5.19	-1.75	-3.10 <sup>e</sup>	-3.75"	-4.19"	...	...
Current account	USD bn cum.	-0.74	-0.78	-0.32	-1.62	-1.31	-1.90 <sup>e</sup>	x	x	x	x
Current account	% GDP, cum.	-3.7	-1.8	-0.4	-1.5	-5.0	-3.2 <sup>e</sup>	x	x	x	x
Gross international reserves	USD bn eop	17.3	17.7	19.1	22.3	22.9	25.9	24.7	25.9	27.3	28.9
Monetary Base	% yoy eop	25.2	22.4	20.3	17.5	27.7	38.4	36.9	38.4	40.6	47.2
Lending rate on UAH credits **	% pa, aop	15.8	15.5	14.6	15.1	14.0	14.1	13.4	14.1	13.9	13.3
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	6.07	6.34	6.43	6.51	6.62	6.81	6.83	6.77	6.90	6.87

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

<b>Key Economic Indicators</b>		<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
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 <sup>o</sup>	1.2 <sup>oo</sup>	1.4	3.1	2.9	6.9	2.5	-1.6
Current account	% GDP	-3.1	2.9 <sup>o</sup>	3.8 <sup>oo</sup>	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

<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.

#### 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