



Monthly Economic Monitor Ukraine

- The Law on the Cabinet of Ministers became the focal point of political conflict in January.
- Real GDP grew by 7.0% yoy in 2006 thanks to strong domestic demand growth.
- The Parliament passed the law allowing privatisation of several large enterprises.
- New steel trade agreement with the EU was initialled in January.
- In 2006 the central fiscal deficit was 0.9% of GDP.
- Real wages grew by 18.4% yoy in 2006 maintaining the previous year trend.
- Consumer prices moved down to 10.9% in January.

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Politics: The Law on Cabinet of Ministers became the conflict point of January

In January the focal point of political agenda was the Law on the Cabinet of Ministers. Such law was debated for a long time in the framework of administrative reform in Ukraine, and was expected to work out in detail principles and procedures of Cabinet of Ministers activities, including its powers and duties. It was expected that this law allows more transparent and efficient operations of the executive branch of the power. However, the Law passed in January contained counter-constitutional norms, reinforcing rather than suppressing conflicts over power distribution.

Moreover, the Law intensified the conflict between the President on one hand, and the Prime Minister and Parliament on the other. The Law was first adopted on December 2006, but vetoed by the President. In January the people's deputies overruled the veto. The President vetoed it again although the Constitution obliged him to sign the law. Despite the second veto of the President, the Law was promulgated at the web-site of the Parliament, signed by the Speaker of the Verkhovna Rada and included into the single state registry of legal norms by the Justice Ministry. Also, it was published in official newspapers in early February, thus formally coming into force. It is expected that the Law will be amended in the near future to put it in line with the Constitution.

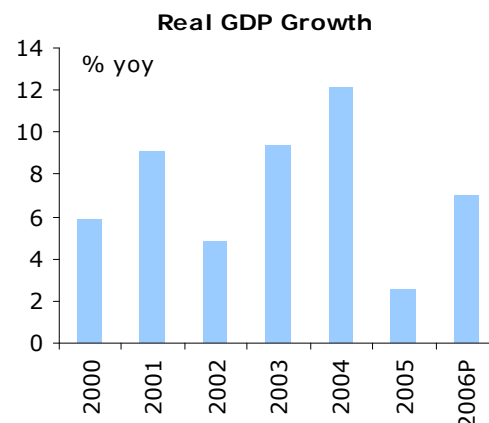
The resignation of the Foreign Minister Borys Tarasyuk accepted by the President has finished the controversy over the Minister's removal from office. In December 2006 Borys Tarasyuk, nominated to the office by the President, was dismissed by the Parliament. The President named him the acting Minister instead, but the Cabinet of Ministers de-facto ignored this decision that created ambiguity and hindered functioning of the Ministry of Foreign Affairs.

Real sector: Real GDP grew by 7.0% yoy in 2006

According to the Derzhkomstat preliminary estimates, real GDP increased by 7.0% yoy in 2006 against 2.7% yoy rise a year before. The growth was chiefly driven by domestic demand. In particular, in the first nine months of 2006 final consumption of households grew by 18.8% yoy backed by strong income rise and sharp expansion of credits to households. Also, the real gross fixed capital accumulation increased by 12.1% yoy between January and September stimulated by both business investments and residential construction demand. Yet other positive impact to GDP growth came from improved conjuncture on world metal markets that revived Ukrainian exports. In the third quarter the growth rate of real exports of goods and services became positive at 1.3% yoy for the first time since 2004.

In 2006 industrial output increased by 6.2% yoy as compared to 3.1% yoy rise a year before. Most evidently the situation improved in metal manufacturing, the output of which increased by 8.9% yoy after 1.5% yoy decline in the previous year. Growth in metal production stimulated the development of linked to it extraction

Population: 47 m
Industry/GDP: 27%
Agriculture/GDP: 10%
Investment/GDP: 19%
Exports to: Russia 18%, EU 29%
Imports from: Russia 40%, EU 32%



Source: Derzhkomstat
P - official estimate

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
<http://www.ier.kiev.ua>

industry (5.8% yoy rise in 2006), especially non-energy materials extraction. In addition, machine building accelerated by 11.8% yoy compared to 7.1% yoy rise a year before thanks to higher investment activity. Furthermore, booming residential housing caused high growth rate of construction materials production

Sectoral trends: The Parliament passed the law allowing privatisation of several large enterprises

Privatization. In January 2007 the Parliament passed the Law that allows privatization of several large companies like telecommunication company Ukrtelecom, chemical factory Odessa Portside Plant, and electrical equipment plant Electrotyazhmash. These objects were already considered for privatization in previous years, but were deemed to be strategic for Ukraine. The State Property Fund proposed to keep majority stake in the state property and to offer only 10% for the initial round of privatization. However, the President considers the state management on these enterprises inefficient and supports their full privatization. The exact terms of privatisation are to be set later during the year. If successfully privatized, they may allow executing the ambitious plan of privatization for 2007 set at UAH 10.6 bn.

Energy. In January the government introduced several changes on gas market, aiming partial market liberalisation. First, it allowed private gas producers to sell extracted gas on auctions, although state-owned companies, e.g. Naftogaz Ukrainy, are still obliged to sell all domestic gas they extract to the households at regulated prices. The decision is applicable to approximately 3% of gas sales on Ukrainian market. Though it is the step towards market liberalization, government interference would not be necessary if gas prices were equal to market prices for all groups of consumers.

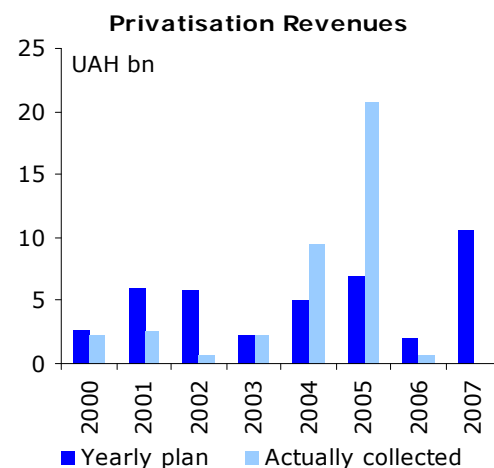
Second, the government changed regulation on payment relations. Now, industrial consumers are allowed to make an agreement on gas supply with gas-traders (Naftogas Ukrainy and UkrGasEnergo) at price including transportation costs without the need for additional agreements with gas transporting and distributing intermediaries (oblgaz). Such a solution will allow gas buyers to establish direct contacts with gas suppliers improving payments discipline.

External sector: New steel trade agreement initialled with the EU

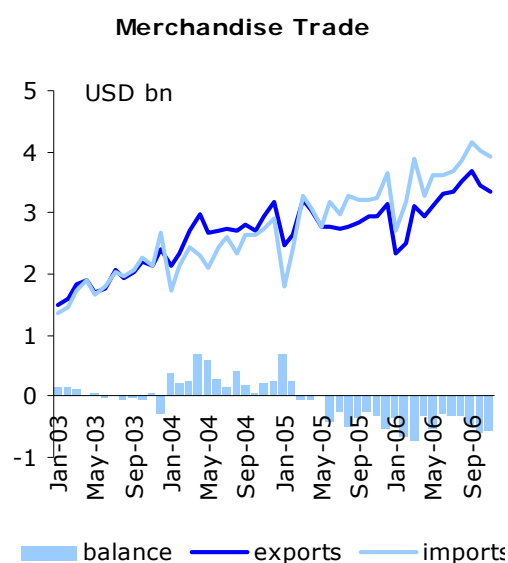
Ukraine and the EU initialled the new agreement on steel trade intended to regulate this issue until Ukraine becomes a WTO member. The agreement envisages 1.32 m ton quota on steel export to the EU that is 18% above quota for 2006. No conditional clauses referring to the level of Ukrainian export tariff on metal scrap are attached to new arrangements. The agreement is expected to be signed in May with the prolongation option for next years. The quota on steel exports will be eliminated immediately after Ukraine's WTO accession, considerably improving the access to the EU market.

The government expanded the list of products subject to import licensing in 2007 as compared to 2006. In addition to beef, pork, cattle and pigs, licensing is introduced for poultry, meat products, sugar, sugar syrup, and prepared food products containing cacao. The official excuse for licensing is the need to enhance food quality control. However, as there exist other quality control instruments like sanitary and veterinary controls, and certification of compliance, licensing seems to impose excessive burden on imports, creating additional protectionist shield for domestic producers at the expense of welfare loss for population.

In the first eleven months of the year commodity exports increased by 11.4% yoy in dollar terms, while imports grew by 22.4% yoy. As a result, the deficit of commodity trade reached USD 5.2 bn compared with USD 1.5 bn a year before. The improved trade regime with the USA boosted exports to Americas by 38.4% yoy. Exports to the CIS and Europe grew by 15.7% yoy and 15.4% yoy respectively, with the steady acceleration of shipments to the latter region thanks



Source: State Treasury



Source: Derzhkomstat



* data for January -- November of a respective year
Source: Derzhkomstat

to increased metal prices. Fastest growth of imports was from Asia (30.4% yoy) and Europe (29.9%), the latter due to high domestic demand for machinery and equipment.

Fiscal policy: The central fiscal deficit accounted for 0.9% of GDP in 2006

In 2006 the central fiscal revenues were executed at 104.2% of the target thanks to high VAT revenues. Also, good collection rates of the enterprise profit tax (EPT) in November and December improved the execution of EPT revenues that reached 100.2% of the target after being under-executed during the most of the year. Such change could be explained by improved economic performance of enterprises as well as better tax administration in the end of the year. Besides, EPT payments usually peak at the end of the year. The execution rate of the central fiscal expenditures was 97.2%, being lower than in the previous years. Education and social protection expenditures, as well as transfers to local budgets, had the highest execution rate. Central fiscal expenditures on the utility sector and culture remained below 90% of the target. The resulting central fiscal deficit constituted UAH 4.9 bn or 0.9% of GDP and was mainly financed by borrowings, while privatisation receipts were minimal.

Social policy: Real wages grew by 18.4% in 2006

In 2006 real wages grew by 18.4% yoy, thus maintaining the previous year trend. The average wage equalled to UAH 1041.4 in 2006. The state administration sector kept the highest growth rates of wages, while growth rates in education and healthcare were lower than average for economy. The growth of wages in industry also lagged behind and reached only 15.0% yoy on the average for the year, partially due to slower wage rise in coke production, petroleum refinement and metal production. But the recovery of production in these sectors in the second half of the year stimulated growth of labour income there. Even though the growth of wages in agriculture was higher than the average for economy, wages in the sector remain the lowest in the economy and reached only UAH 552.9.

Monetary policy: Consumer prices move down to 10.9% in January

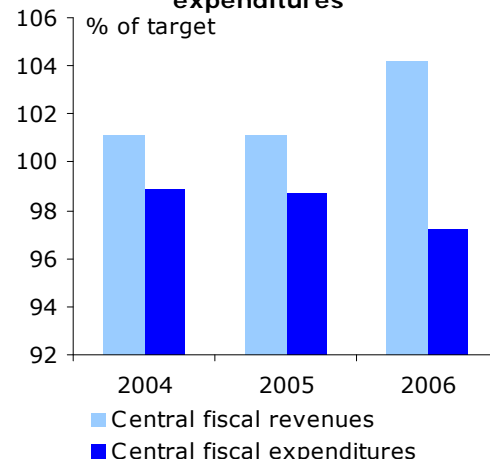
Deceleration of utility tariff increases and slump in demand for food products after winter holidays helped to slow down CPI growth to 10.9% yoy in January marking an end of six-month CPI acceleration. However, we expect annualized inflation to remain in double digits as further increases in regulated prices and tariffs caused by increase in import gas price in January 2007 are anticipated.

Monetary base growth accelerated to 26.7% yoy and monetary supply growth to 36.8% yoy as the accumulation of funds by the government at the beginning of the year was of less magnitude than in 2006. Furthermore, the foreign exchange market was balanced without much interventions of the NBU despite seasonally smaller export revenues, and NBU even bought USD 223 m into reserves as compared to the sale of USD 938 m in January 2006.

Financial markets: Reliance on external borrowing increased in 2006

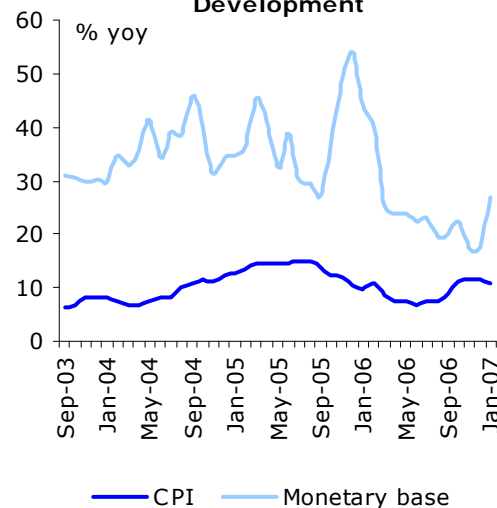
State debt. Ukraine further increased its reliance upon external state debt financing in 2006. The overall stock of direct internal state debt decreased by UAH 2.6 bn to UAH 16.6 bn as repayments were larger than new borrowings, while direct external debt increased to UAH 49.5 bn from UAH 44.0 bn and its share in total direct state debt reached 74.9%. As the Ministry of Finance was reluctant to offer attractive yields to domestic buyers, only modest UAH 1.6 bn worth of domestic bonds was sold. At the same time, Ukraine sold USD 1.9 bn in Eurobonds, of which only USD 1 bn was placed publicly. Preference for external borrowing will further delay development of government bond market in Ukraine, which can provide benchmark prices crucial for financial markets development and allow the NBU use such monetary policy instrument as open market operations.

Execution of the central fiscal revenues and expenditures



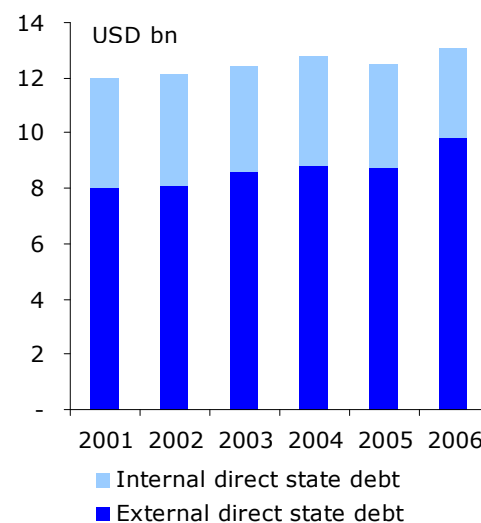
Source: State Treasury reports

CPI and Monetary Base Development



Source: Derzhcomstat, NBU

Direct state debt in 2001-2006



Source: Ministry of finance



Economic Trends		Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Sep	Oct	Nov	Dec	Jan
GDP growth (real)	% yoy	1.7	3.2	7.3	8.0	...	8.9	9.0	8.2
GDP growth (real)	% yoy cum.	2.6	3.2	5.4	6.5	7.0	6.2*	6.5*	6.7*	7.0*	...
Industrial production (real)	% yoy cum.	3.1	0.2	3.6	5.5	6.2	5.5	5.3	5.6	6.2	...
Agricultural production (real)	% yoy cum.	0.0	4.0	3.2	-2.8	0.4	-2.8	-1.1	-0.9	0.4	...
CPI	% yoy eop	10.3	8.6	6.8	9.1	11.6	9.1	11.0	11.6	11.6	10.9
PPI	% yoy eop	9.6	6.5	6.3	10.7	14.4	10.7	13.1	14.0	14.4	15.6
Exports (USD)***	% yoy cum.	7.5	-0.3	4.7	10.7	...	10.4"	11.2"	11.4"
Imports (USD)***	% yoy cum.	20.4	24.9	19.7	19.8	...	22.2"	22.6"	22.4"
Merchandise trade balance	USD bn cum.	-1.14	-1.29	-2.16	-2.93	...	-4.06"	-4.64"	-5.22"
Current account	USD bn cum.	2.53	-0.74	-0.78	-0.32	...	x	x	x	x	...
Current account	% GDP, cum.	3.0	-3.7	-1.8	-0.4	...	x	x	x	x	...
Gross international reserves	USD bn eop	19.39	17.3	17.7	19.1	22.3	19.1	19.5	21.2	22.3	22.4
Monetary Base	% yoy eop	53.9	25.2	22.4	20.3	17.5	20.3	22.5	17.2	17.5	26.7
Lending rate on UAH credits **	% pa, aop	16.4	15.8	15.5	14.6	15.1	14.6	14.3	14.4	15.1	14.2
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	6.00	6.07	6.34	6.43	6.51	6.43	6.37	6.49	6.67	6.57

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		1999	2000	2001	2002	2003	2004	2005	2006
Nominal GDP	UAH bn	130.4	170.1	204.2	225.8	264.2	345.9	424.7	527.4 ^e
Nominal GDP	USD bn	31.6	31.2	37.8	42.6	49.5	65.1	83.1	104.4 ^e
GDP growth (real)	% yoy	-0.2	5.9	9.2	5.2	9.4	12.1	2.6	7.0 ^e
Industrial production	% yoy	4.0	13.2	14.2	7.0	15.8	12.5	3.1	6.2
Agricultural production	% yoy	-6.9	9.8	10.2	1.2	-11.0	19.1	0.0	0.4
CPI	% yoy aop	22.7	28.2	12.0	0.8	5.2	9.0	13.5	9.1
CPI	% yoy eop	19.2	25.8	6.1	-0.6	8.2	12.3	10.3	11.6
PPI	% yoy aop	31.5	20.9	8.6	3.1	7.8	20.4	16.8	9.5
PPI	% yoy eop	15.7	20.8	0.9	5.7	11.2	24.1	9.6	14.2
Exports (gs, USD)	% yoy	-7.9	17.9	9.5	10.7	24.0	42.6	7.5	...
Imports (gs, USD)	% yoy	-19.1	18.9	14.1	4.9	28.7	31.3	20.4	...
Current account	USD bn	0.9 ^o	1.2 ^{oo}	1.4	3.1	2.9	6.9	2.5	...
Current account	% GDP	2.9 ^o	3.8 ^{oo}	3.7	7.6	5.9	10.6	3.0	...
FDI (net)	USD bn	0.5	0.6	0.8	0.7	1.4	1.7	6.5	...
International reserves	USD bn	1.09	1.48	3.09	4.42	6.94	9.52	19.39	22.26
Fiscal balance ^{'''}	% GDP	-2.1	-0.7	-1.9	0.8	-0.2	-3.4	-1.82	-0.94 ^e
Total state debt	% GDP eop	61.0	45.3	36.5	33.5	29.0	24.7	17.7	15.3
External debt (total)	% GDP eop	49.9	33.1	26.3	24.1	21.3	18.7	13.4	12.1
Monetary base	% yoy eop	39.3	39.9	37.4	33.6	30.1	34.1	53.9	17.5
Exchange rate	USD aop	4.13	5.44	5.37	5.33	5.33	5.31	5.12	5.05
Exchange rate	USD eop	5.07	5.44	5.30	5.33	5.33	5.31	5.05	5.05
Exchange rate	EUR aop	4.39	5.03	4.81	5.03	6.02	6.62	6.40	6.32
Exchange rate	EUR eop	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.

^e Preliminary estimate

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