

# Monthly Economic Monitor Ukraine

- Parliamentary re-elections are scheduled for May 27.
- In the first two months of the year GDP increased by 8.6% yoy.
- The state renewed its practice of non-transparent privatization.
- In January 2007 growth rates of commodity exports and imports significantly accelerated compared to the previous year.
- The annual central fiscal deficit was increased to 2.6% of GDP according to the amended budget law.
- The minimum wage and subsistence minimum are to be increased.
- Inflation increased up to 10.1% yoy in March.

No.4 (78)  
April  
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: New parliamentary elections are likely

In March Verkhovna Rada almost unanimously appointed Arseniy Yatsenyuk, the first deputy chief of the president's staff and a former Minister of Economy, as a Foreign Minister. President's nomination for Mr. Yatsenyuk came after two months of unsuccessful attempts to appoint Mr. Ohrysko, a professional diplomat, to this position. Mr. Yatsenyuk's appointment was favourably perceived as a sign of quieting tensions between the President and the parliamentary coalition. Newly appointed minister indicated that he would give special attention to the economic aspects of the foreign policy.

However, by the end of the month a political crisis aggravated after the appointment of Anatoly Kinakh, the leader of the Party of Entrepreneurs and Industrialists and the member of oppositional "Our Ukraine" block, as a new Minister of Economy on March 21, 2007. This happened as a result of his negotiations with the coalition and against the will of his block. In turn, some opposition deputies changed their political status. During the following two days the opposition lost 13 deputies. Although such "moves" had already happened in the past, the March events brought the problem of unstable political stance to its utmost peak. The opposition leaders and a number of coalition members claimed that due to individual transits the coalition would soon reach a constitutional majority of 300 out of 450 members of Verkhovna Rada. The Constitution remains vague on the possibility of individual transits from opposition to coalition while simultaneously keeping factional membership.

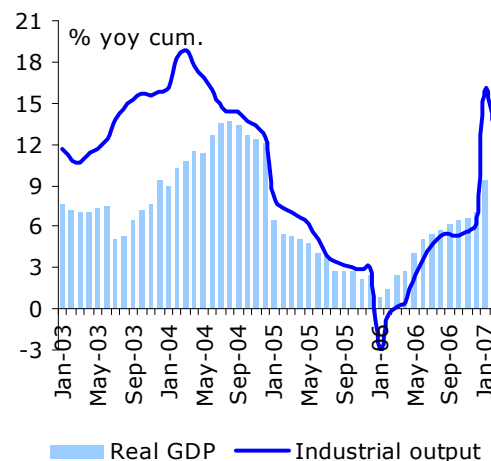
The President interpreted such actions as a violation of the Constitution and on April 2 signed the decree that dissolved Verkhovna Rada and scheduled new parliamentary elections for May 27. The coalition refused to accept the president's decree. Moreover, the parliament approved a resolution prohibiting the government to take any actions on organizing and financing early elections. At the same time, the coalition filed the claim to the Constitutional Court to consider the constitutionality of the presidential decree.

## Real Economy: Real GDP increased by 8.6% yoy

According to the Derzhkomstat, between January and February 2007 the real GDP growth was 8.6% yoy compared to the 1.5% yoy increase during same period in 2006. The highest growth rates occurred in construction, manufacturing and trade. In particular, high growth rates in construction (18.7% yoy) can be explained by an unprecedented increase in demand for both residential and industrial buildings. The only sector with declining value added was electricity, gas and water supply. This situation may be partially explained by higher utility prices and therefore a lower demand. In addition, a relatively mild winter accounts for a portion of this decline.

In the first two months of the year industrial output increased by 13.4% yoy, led by growth in manufacturing. The highest growth occurred in machine building that increased by 28.1% yoy due to improved domestic demand and growing exports to the CIS.

GDP and Industrial Output



Source: Derzhkomstat

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## Sectoral trends: Return to murky privatization schemes

**Privatization.** The State Property Fund (SPFU) received UAH 292.5 m from the sale of 76% shares of state-owned Lugansk locomotive plant. The buying price was only UAH 0.5 m more than the starting price at the auction. This enterprise should have been privatized earlier. However, court decisions delayed the sale, last time in October 2006. Among four applicants only two companies were allowed to participate in the auction, both belonging to the Russian "Transmashholding". The official buyer of the property is the "Bryansk machine-building plant". The fairness and transparency of the auction is questionable and likely to be challenged in court.

The SPFU approved the sale procedure of the joint-stock company (JSC) "Ukrtelecom". State will remain controlling shareholder with 50%+1 shares, 37.86% are to be sold at the international stock market and 5% at the domestic. Other shares of this telecommunication operator belong to its employees. The sale of the company is expected in 2007 and may allow fulfilling the privatization budget set at ambitious UAH 10.6 bn.

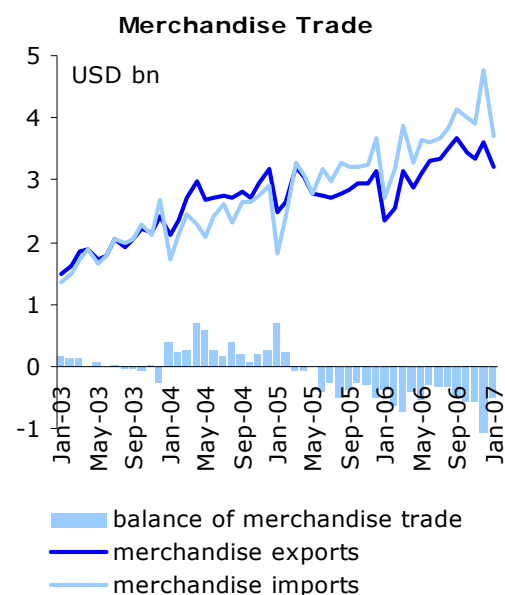
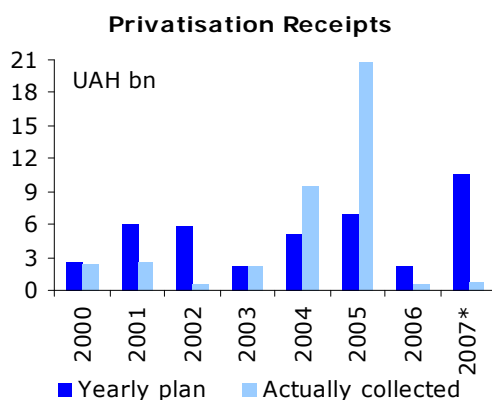
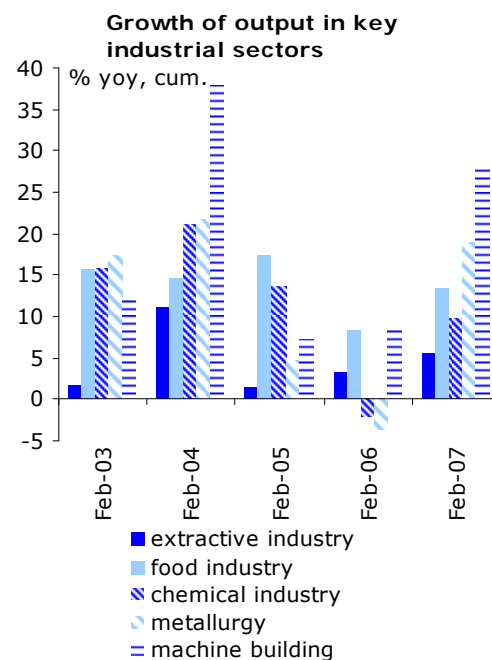
**Agriculture.** In March the Parliament approved a Law "On the State Land Cadastre". The lack of this law was one of the major justifications for continuing farmland moratorium back in January. The purpose of the cadastre is to provide a description of physical characteristics of land parcels. It contains a map and a registry of land parcels where these characteristics are recorded. A registry of land parcels provides information on the legal status of a land parcel and is kept by the State Land Committee of Ukraine. Even though there are concerns that the law is incomplete, it is clearly a positive development. It is one of the necessary prerequisites for elimination of farmland sales moratorium, urgently required for agriculture and rural community development.

**Utilities.** The government reorganized the Ministry of Building, Architecture, Housing and Communal Services and established two separate bodies: the Ministry of Regional Development and Construction and the Ministry of Housing and Utility Services. The latter will be in charge of government policy in the utilities sector. However, structural reorganization will not automatically guarantee investments and acceleration of market reforms.

**Energy.** In March "UkrInterEnergo", the exporter of Ukrainian electricity, sold 100 MW of export capacities for the second quarter of 2007 in four lots at the first open electricity auction. All lots were bought by the Hungary's Energy Capital that paid an average of USD 89 per MWh of electricity. Since the starting price was only 54 USD per MWh, it showed the real market price of Ukrainian electricity is higher than what was paid in the past. It is the right step towards the electricity export market liberalization. However, this new practice would not directly benefit power generation companies. Therefore, further reforms are needed.

## External sector: Commodity trade accelerated in January

According to the Derzhkomstat, in January 2007 growth rates of commodity exports and imports significantly accelerated compared to 2006, although the trade balance remained negative at USD 0.5 bn. Exports increased by 37.2% yoy in dollar terms, while imports grew by 36.5% yoy. Increased metal exports was a key contributor to high export growth, followed by machinery and equipment, and products of the chemical and allied industries. This compensated the drop of grain exports due to state intervention: introduction of an export quota on grain in October 2006. It is estimated that the direct monthly loss due to quota constitutes approximately USD 100 m. In term of imports, the highest growth occurred in mineral fuels as well as in machinery and equipment. If the former is explained by increased energy prices, the latter is related to growing domestic demand for investment goods and durables.



### Fiscal policy: The planned central fiscal deficit was increased to 2.6% of GDP

In March the Parliament approved amendments to the State Budget Law for 2007. The central fiscal expenditures were raised by 4.7% to UAH 169.4 bn to fund increased minimum wages and subsistence minimum. It will be partially financed from the central fiscal revenues that were revised upwards by UAH 4.6 bn due to higher than officially estimated economic growth during the first two months of the year. At the same time, the planned fiscal deficit was increased by UAH 2.9 bn to 2.6% of GDP. This increase will be financed from the funds accumulated at the unified treasury account. The government did not revise its plans for privatization receipts, which are to be the major source of the deficit financing in 2007. Significant changes in revenues upwards early in the year might create additional fiscal risks later if economic growth decelerates.

Between January and February central fiscal revenues were 107.3% of the target level thanks to increased tax revenues. In particular, the VAT and enterprise profit tax revenues exceed the target by 9.8% and 6.5%, respectively, due to high economic growth. The execution of general central fiscal expenditures improved but remained low at 78.6% of the plan. Traditionally, social payments were executed at the highest level at 93.0% of the target. The central fiscal surplus reached UAH 4.6 bn or 5.3% of the GDP.

### Social policy: The minimum wage and subsistence minimum were increased

According to the budget amendments approved in March, the minimum wage and subsistence minimum are to be increased above the levels planned in December. Moreover, these indicators will grow faster than it was envisaged by the earlier parliament's resolution. By October, the minimum wage and average subsistence minimum will reach UAH 460 and UAH 532, respectively. The minimum pension will also be increased and set equal to an amount that is 1% higher than the subsistence minimum for people that lost their ability to work (UAH 415 in October). Thus, the government has returned to the harmful practice of the revision of social and minimum wage during the budget year. The minimum wage growth will result in higher labour costs for enterprises and, as a result, reduced investment spending which is important for economic development.

### Monetary policy: Inflation increased to 10.1% yoy

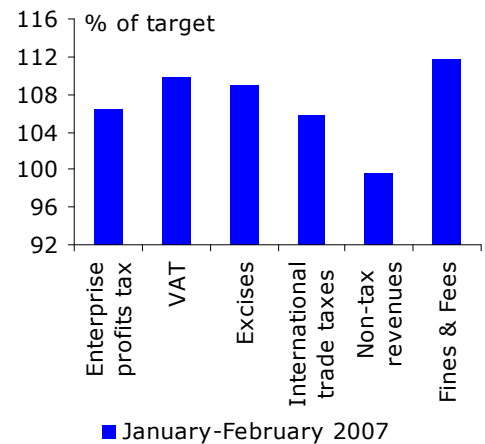
Inflation rate returned to double digits and reached 10.1% yoy mainly due to statistical base effect, though food prices continued to grow slowly and the wave of utility price increases receded. Further changes in inflation rate will partially depend on the government's price policy, as the government officials made several statements regarding possible "cures" that would bring the inflation rate down.

The monetary base grew by 27.7% yoy and the money supply grew by 39.6% in March as compared to 21.1% and 36.6% yoy in February as NBU interventions on foreign currency market were quite high. The NBU reacted to high levels of surplus liquidity in the banking sector by selling deposit certificates to banks.

### Financial markets: So far problem loans grow slower than total credits outstanding

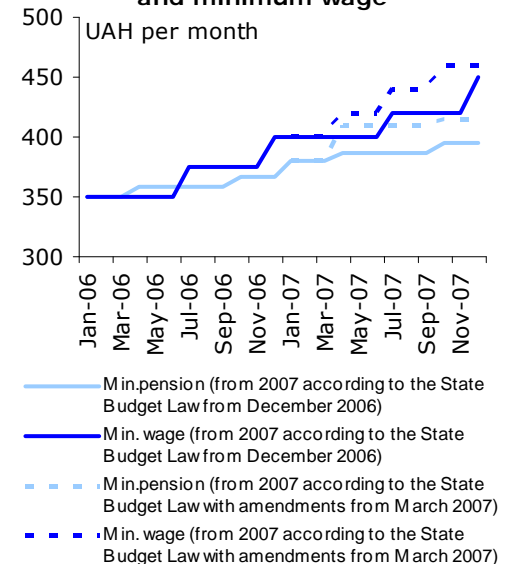
**Banking sector.** So far the credit boom in the country was not accompanied with growth of problem loans. According to the NBU, in February credits outstanding increased by 71% yoy, while problem loans in the banking sector grew significantly slower at 34% yoy and account for only 1.75% of total credits. However, this situation may change as credits will be closer to maturity and indebtedness increases, especially if accompanied by decelerated economic growth, calling for further improvement in bank risk management and supervision.

### Central fiscal revenues execution



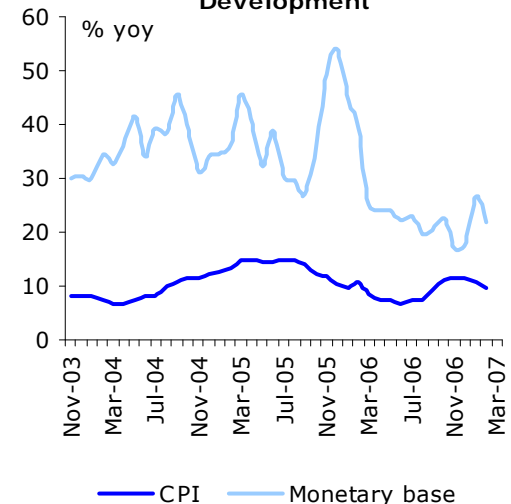
Source: State Treasury reports

### Monthly minimum pension and minimum wage



Source: State Budget law for 2006, State Budget Law for 2007

### CPI and Monetary Base Development



Source: Derzhcomstat, NBU



Economic Trends		Q4 05	Q1 06	Q2 06	Q3 06	Q4 06	Nov	Dec	Jan	Feb	Mar
GDP growth (real)	% yoy	1.7	3.2	7.3	8.0	...	8.2	...	9.3	7.9	...
GDP growth (real)	% yoy cum.	2.6	3.2	5.4	6.5	7.0	6.7*	7.0*	9.3	8.6	...
Industrial production (real)	% yoy cum.	3.1	0.2	3.6	5.5	6.2	5.6	6.2	15.8	13.4	...
Agricultural production (real)	% yoy cum.	0.0	4.0	3.2	-2.8	0.4	-0.9	0.4	6.9	5.6	...
CPI	% yoy eop	10.3	8.6	6.8	9.1	11.6	11.6	11.6	10.9	9.5	10.1
PPI	% yoy eop	9.6	6.5	6.3	10.7	14.4	14.0	14.4	15.6	16.5	17.9
Exports (USD)***	% yoy cum.	7.5	-0.3	4.7	10.7	13.2	11.4"	12.1"	37.2"	...	...
Imports (USD)***	% yoy cum.	20.4	24.9	19.7	19.8	22.0	22.4"	24.6"	36.5"	...	...
Merchandise trade balance	USD bn cum.	-1.14	-1.29	-2.16	-2.93	-5.19	-5.22"	-6.67"	-0.49"	...	...
Current account	USD bn cum.	2.53	-0.74	-0.78	-0.32	-1.62	x	x	x	x	x
Current account	% GDP, cum.	3.0	-3.7	-1.8	-0.4	-1.5	x	x	x	x	x
Gross international reserves	USD bn eop	19.39	17.3	17.7	19.1	22.3	21.2	22.3	22.4	22.4	23.0
Monetary Base	% yoy eop	53.9	25.2	22.4	20.3	17.5	17.2	17.5	26.7	21.7	27.7
Lending rate on UAH credits **	% pa, aop	16.4	15.8	15.5	14.6	15.1	14.4	15.1	14.2	13.9	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	6.00	6.07	6.34	6.43	6.51	6.49	6.67	6.57	6.60	6.68

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	535.9
Nominal GDP	USD bn	41.9	31.6	31.3	38.0	42.4	50.1	65.0	86.2	106.1
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:

<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