



Monthly Economic Monitor Ukraine

- Early parliamentary elections are scheduled for September 30.
- In the first four months of the year the real GDP increased by 7.9% yoy.
- The second attempt to sell 1% of Ukrtelecom shares on domestic market failed.
- On May 31 the Verkhovna Rada passed 11 laws required to harmonize the legislation with the WTO rules and requests.
- The budget amendments passed in May envisage further growth in wages and social payments in 2007.
- Wages in public sector will increase with the implementation of the second stage of the Unified Tariff Scale.
- Inflation moved to 10.6% yoy in May.

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Politics: A compromise was reached over early parliamentary elections

A two-month political crisis has reached its peak in May. On May 27, the President, Prime Minister and Speaker of the Verkhovna Rada agreed to conduct pre-term elections scheduling the event for September 30, 2007. As a result of the compromise, at least 150 of deputies from oppositional factions had to quit the Parliament providing a legitimate reason for early elections. The President, in turn, suspended his Act on dissolution of the Parliament enabling the Verkhovna Rada to approve necessary amendments and laws for the pre-term parliamentary elections.

On June 1, 2007 the Verkhovna Rada approved amendments to the Law on Parliamentary Elections and some other legal acts. One of the most important amendments was a 50% voter turnout required to consider pre-term elections as valid. At the same time, the issue of "imperative mandate", that was one of the reasons for the constitutional crisis, remained unresolved. The Verkhovna Rada rejected a draft amendment on introduction of the imperative mandate.

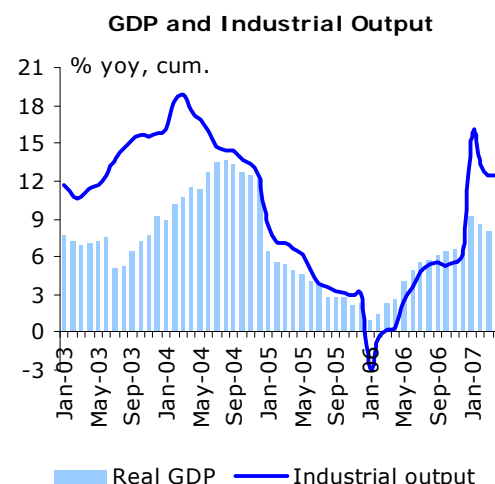
Although nearly 160 deputies declared their exit from the Verkhovna Rada, the Parliament refused to automatically accept their declaration claiming that the exit procedure had not been properly fulfilled. At the same time, on June 5 the President issued the Decree scheduling elections at September 30, claiming that the quit of deputies made the Verkhovna Rada incompetent.

Real Economy: Real GDP increased by 7.9% yoy during the first four months

According to Derzhkomstat, in the first four months of 2007 real GDP grew by 7.9% yoy. On the demand side, domestic private demand remained strong in April and is estimated to be a major contributor to real GDP growth. In particular, in the first quarter investments in fixed capital significantly increased (32.0% yoy). A series of natural gas price increases, a possibility of future jumps in energy prices and increasing competition stimulated enterprises to replace outdated equipment and adopt energy-saving technologies. On the supply side, real GDP growth relied mostly on a strong increase in value added in manufacturing and trade.

Industrial production growth remained high and in the first four months of the year was reported at 12.5% yoy, compared to a 0.7% yoy increase a year ago. Machine building remained a key contributor to industrial growth reflecting the growth in investment activity. Stable demand on world metal markets had been another factor stimulating industrial growth. A recovery was observed in the textile production possibly because of high external demand and move of some firms from the shadow economy.

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%



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Sectoral trends: The sale of 1% Ukrtelecom shares on domestic market failed

Privatization. On May 30 the second attempt to sell 1% shares of the telecommunication company Ukrtelecom failed due to the absence of bids. The first tender scheduled for May 22 was cancelled by a court decision although there were three bids for this tender. The lack of bids at the second auction could be explained by the legal risks associated with the purchase. The next auction is expected on June 5. The State Property Fund plans to put up for sale on the Ukrainian stock exchange market three of the five 1% shareholdings during the summer of 2007 and the remaining 37.86% on the international market. Problems with the sale of shares on the domestic market question the success of Ukrtelecom privatisation this year, endangering the plan for privatisation receipts for 2007.

Utilities. The regional court of Kharkiv suspended the decision of the National Electricity Regulatory Commission (NERC) on differentiated gas prices for households in May 2007. This happened after numerous enquires of consumers that suffered from the new tariff scheme that envisaged progressive growth in gas price depending upon the volume of consumption. The NERC has not acknowledged the court order, continuing charging differentiated prices. The court appeals are expected.

Transportation. In May 2007 prices for freight rail transportation increased by 2% and lump-sum rates in ports by 5%. Meanwhile, an additional 5% port tariff raise is expected in July, August, September and November 2007 with the cumulative growth of 25% compared to the rate in April. These steps are mostly due to the necessity to cover the growing costs of transportation and replace outdated equipment. The lack of equipment even forced "Ukrzaliznytsya" to introduce discounts at the level of 15-51% for the freight forwarders with their own cars. However, the transparency of tariff setting remains low. The establishment of an independent tariff regulator and acceleration of the reforms in transportation are crucial for its development.

External sector: Parliament passed 11 laws required by the WTO

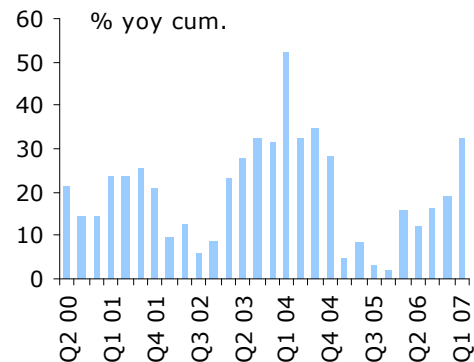
On May 31 the Verkhovna Rada passed 11 laws required to finalize the harmonization of the legislation with the WTO rules and requests. The laws focus on the VAT regime, genetically modified organisms, export tariffs, counterfactual products, among others. These laws will expedite Ukraine's accession to the WTO. Unresolved issues include aggregate measure of support in agriculture and the bilateral agreement with Kyrgyzstan.

According to Derzhkomstat, commodity exports increased by 33.0% yoy in dollar terms between January and March, while imports grew by 32.2% yoy. The trade deficit reached USD 2.2 bn. The exports to all regions increased, with particularly strong growth rates in exports to the CIS (61.2% yoy) and Europe (34.5% yoy). The upsurge of exports to these regions could be partially explained by high world prices for metals. In the case of the CIS, the second important factor was the increase in exports of machinery and equipment. The highest growth of imports was from Asia at 43.9% yoy. Here, the imports of consumer goods, including durables, from China took the lead. However, the largest share of imports still comes from the CIS (mineral products) and Europe (investment goods and durables).

Fiscal policy: The budget amendments envisage further expansion of wages and social payments in 2007

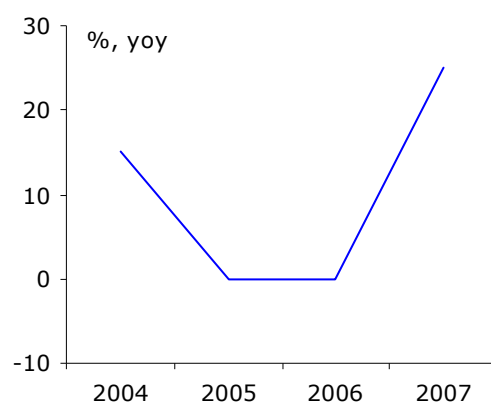
In May the Parliament approved amendments to the State Budget Law for 2007. Central fiscal revenues increased by UAH 3.7 bn, which are to be received from the VAT and EPT (UAH 3.3 bn and UAH 0.4 bn respectively). The additional funds will be spent for wage increases in public sector and higher social payments. No change in deficit is envisaged. Thus, the government continued the expansion of social spending started in March.

Investment in Fixed Capital



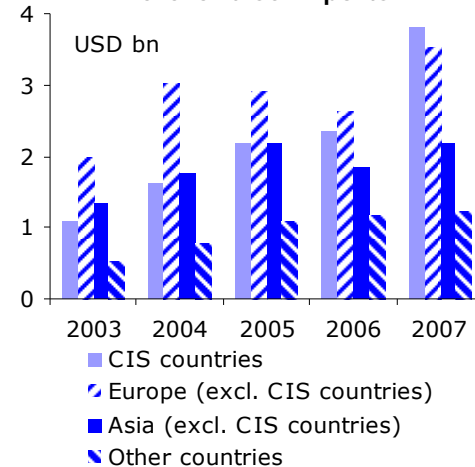
Source: Derzhkomstat

Port tariffs growth



Source: Ministry of Transport and Telecommunications

Regional Distribution of Merchandise Exports*



* data for January -- March of a respective year

Source: Derzhkomstat

Between January and April, central fiscal revenues were executed at 106.1% of the target due to continued stable tax revenues. In particular, revenues from the enterprise profit tax (EPT) were over-executed by 15.3% backed by high economic growth. The execution rate of the VAT revenues was also 3.8% higher than the plan. At the same time, the execution rate of central fiscal expenditures remained low at only 86.1% of the target. Health care and utility sector financing was executed at 67.1% and 21.1% of the target, respectively. The social protection expenditures and transfers to local budgets showed traditionally high execution rates (96.1% and 98.8% of the plan). As a result, the central fiscal surplus amounted to UAH 0.3 bn or 0.2% of the GDP.

The Cabinet of Ministers approved the Concept of Local Budgets Reform, where it declared the main principles of inter-budgetary relations reform. The reform includes performance improvement of local government, introduction of new revenue sources and medium-term expenditure planning. The reform is to be completed by 2011 and is expected to improve sustainability of local government.

Social policy: Wages in the public sector will increase

To implement the second stage of the Unified Tariff Scale in the public sector on June 1, 2007, a number of budget amendments including additional funding (UAH 4.2 bn) was passed in May. According to reform, the wage difference between the highest and the lowest paid employees will increase from 3.35 to 3.93 times. As a result, the wage differentiation of public employees based on their qualification will increase. This policy is expected to increase average wages in education and health care, where wages are among the lowest. However, the approval of these changes during the budget year could be counterweighted by the reduction of premiums and benefits paid, as it had already happened in the past.

Since the change in wages leads to higher revenues of the Pension Fund, the government amended the Fund's budget. As a result, the plan for own revenues of the Fund was raised by 3.98% to UAH 70.0 bn. At the same time, the expenditures of the Pension Fund were raised by 5.8% to UAH 95.6 bn due to higher than previously expected pension increase. While the budget of the Pension Fund is maintained with a zero deficit, the central fiscal transfer to the Fund remained high and was further increased by 11.5% to UAH 24.9 bn.

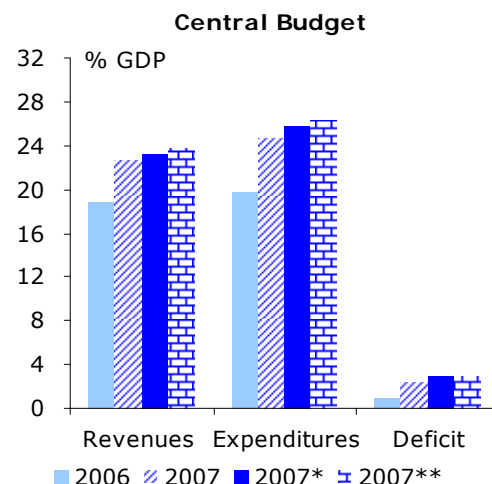
Monetary policy: Inflation moved to 10.6% yoy

Inflation rate accelerated slightly and reached 10.6% yoy in May due to continued food price growth, and despite slightly decreased utilities prices. So far, the political crisis didn't impact inflation significantly. However, wage increase in the public sector may cause some inflationary pressures in the future.

In May the NBU decreased the discount rate from 8.5% to 8.0% effective June 1, reflecting optimistic inflation projections by the NBU, low inter-bank credit interest rates and the NBU intention to further ease the monetary policy. A lower discount rate and recently adopted consumer credit disclosure rules that make the consumer credit market more transparent may result in a decline of interest rates in the economy. The monetary base growth accelerated to 36.9% yoy in May as the NBU increased interventions on inter-bank currency market to USD 1.4 bn.

Financial Markets: New trading system will improve market liquidity

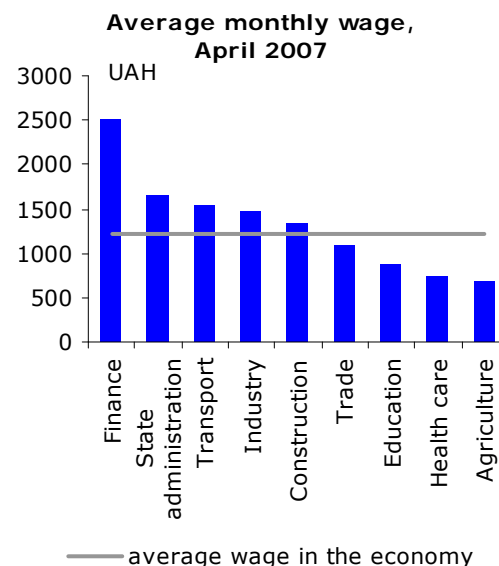
In May Securities Trading System (PFTS) introduced an order-driven trading platform. It allows investors submitting multiple orders during trading. If bid matches with the sell offer the deal is settled automatically the same day, as the full amount of the order has to be deposited in advance. The platform is mostly targeting national investors as the deals are to be conducted in hryvnias. This innovation is expected to increase the number of deals on the Ukrainian stock market and improve its liquidity.



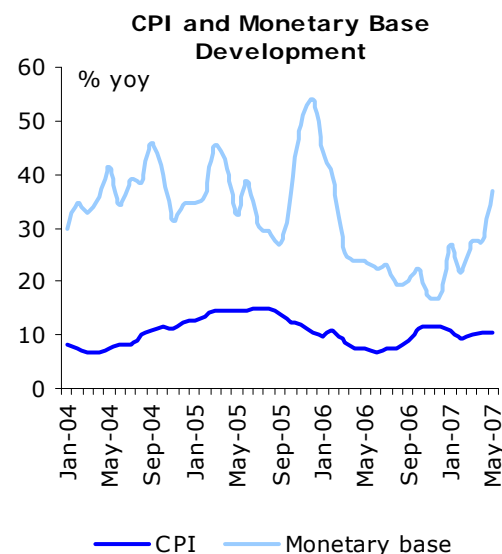
* as amended on March 27, 2007

** as amended on May 30, 2007

Source: State Treasury, Budget Laws



Source: Derzhkomstat



Source: Derzhcomstat, NBU



Economic Trends		Q1 06	Q2 06	Q3 06	Q4 06	Q1 06	Jan	Feb	Mar	Apr	May
GDP growth (real)	% yoy	4.1	6.8	6.9	9.5	...	9.3	7.9	7.0	7.6	...
GDP growth (real)	% yoy cum.	4.1	5.5	6.1	7.1	...	9.3	8.6	8.0	7.9	...
Industrial production (real)	% yoy cum.	0.2	3.6	5.5	6.2	12.5	15.8	13.4	12.5	12.5	...
Agricultural production (real)	% yoy cum.	4.0	3.2	-2.8	0.4	5.0	6.9	5.6	5.0	6.4	...
CPI	% yoy eop	8.6	6.8	9.1	11.6	10.1	10.9	9.5	10.1	10.5	10.6
PPI	% yoy eop	6.5	6.3	10.7	14.4	17.9	15.6	16.5	17.9	18.7	20.2
Exports (USD)***	% yoy cum.	-0.3	4.7	10.7	13.2	33.0	37.2"	34.5"	33.0"
Imports (USD)***	% yoy cum.	24.9	19.7	19.8	22.0	32.3	36.5"	35.7"	32.2"
Merchandise trade balance	USD bn cum.	-1.29	-2.16	-2.93	-5.19	-1.8 ^e	-0.49"	-1.38"	-2.22"
Current account	USD bn cum.	-0.74	-0.78	-0.32	-1.62	-1.2 ^e	x	x	x	x	x
Current account	% GDP, cum.	-3.7	-1.8	-0.4	-1.5	-4.6 ^e	x	x	x	x	x
Gross international reserves	USD bn eop	17.3	17.7	19.1	22.3	23.0	22.4	22.4	23.0	23.5	24.5
Monetary Base	% yoy eop	25.2	22.4	20.3	17.5	27.7	26.7	21.7	27.7	27.7	36.9
Lending rate on UAH credits **	% pa, aop	15.8	15.5	14.6	15.1	14.0	14.2	13.9	14.0	14.1	13.4
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	6.57	6.60	6.68	6.81	6.83

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