



Monthly Economic Monitor Ukraine

- More than 150 deputies resigned leading to the incapability of Verkhovna Rada.
- Real GDP growth remained at 7.9% yoy during the first five months of the year.
- Export quotas were introduced for wheat, barley, corn and rye.
- Current account deficit increased to USD 1.3 bn (5% of GDP) in the first quarter.
- Central fiscal revenues were 4.8% above the target between January and May.
- Real household incomes grew by 17.5% yoy in the first four months of the year.
- Inflation accelerated to 13.0% yoy in June.

**No.7 (81)
July
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 turns in the political game

On June 15, 2007 more than a third of the Parliament members representing the opposition left the Verkhovna Rada. To guarantee the Parliament dissolution "Our Ukraine" and Yulia Tymoshenko's Block cancelled electoral lists established for the previous elections. This should have insured that the deputies that left the Parliament would not be automatically replaced. This cancellation has to be verified and approved by the Central Electoral Commission.

However, on June 1, 2007 a law was issued that prohibited a block or a party to cancel its electoral list. The law contains a contradictory statement concerning the timing of its entry into force (immediately or 60 days after its issuance). Thus, it is not clear if the Central Electoral Commission will have to follow it.

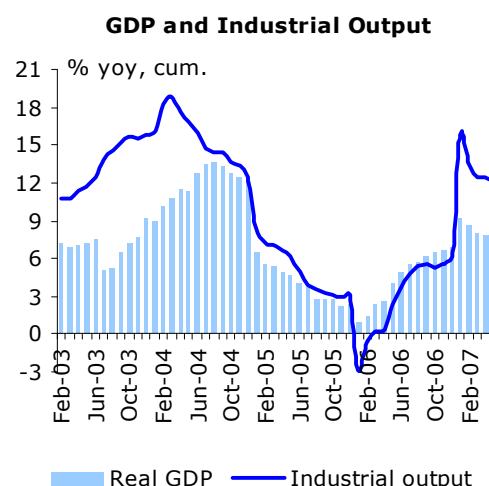
The possible solution could be the a fourth Decree on dissolution of the Verkhovna Rada by the President. It will be less contradictory than his previous acts, as it will dissolve the Rada after it has not been in operation for 30 days. According to the constitution this provides legitimate reason for dissolution.

A summit of the Organization for Democracy and Economic Development - GUAM took place in Baku on June 18-19. The purpose of the summit was to plan GUAM's future activities in economic and security areas, and intensify cooperation. The parties have agreed to continue the project of the railroad and ferry route construction to connect Baku, Tbilisi, Poti and Kerch as well as to establish joint peacemaking forces to participate in the UN and the OSCE missions.

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

Between January and May 2007 the real GDP growth did not change as compared to four-month period and remained at 7.9% yoy despite the political uncertainty. While growth of value added in agriculture, industry, and construction decelerated in May, the real GDP development relied more on service sectors, especially trade. Among the major risks for real GDP growth in 2007 is a sharp downturn in agricultural production in the summer as the grain harvest is expected to be a significantly lower than last year due to the drought.

According to the Derzhkomstat, during the first five months of the year industrial output grew at 12.1% yoy compared to 2.6% yoy rise last year. One of the highest rates of growth was observed in the production of vehicles and transportation equipment at 29.3% yoy. Continued growth in household demand for passenger cars supported by increasing incomes and bank loans accounts for a large portion of the success in this sector. Favorable situation at the world market and boom in construction insured stable and high growth rates in metal production, woodwork production, and production of construction materials.



Source: Derzhkomstat

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Sectoral trends: Export quotas for crops were introduced in June

Agriculture. Lasting drought this spring created unfavourable conditions for crops in Ukraine and 2007 grain harvest is expected to be lower than last year. The Government reacted by introducing export quotas for wheat, barley, corn and rye from July 2007 until October 2007 allegedly to ensure food security and price stability for bread. For each of these products the export quota will be 3000 ton, which is *de facto* grain export ban. With the grain export restrictions the Government may keep grain and bread prices low. However, the economic costs of this policy are very high, and there are better options available to achieve these goals in Ukraine.

Energy. On June 14 the second open auction on electricity sales was organized by state enterprise "Ukrinterenergo". Four lots were purchased by the Hungarian company "Energy Capital ZRT" for USD 90.75/MWh, almost 70% above the initial price. For comparison, the average spot price in the EU on electricity is EUR 60/MWh, and prices for the EU households are almost twice higher. An introduction of open electricity auctions is an important step for stimulating competition on Ukraine's market and improving international electricity flows. However, the amount of electricity sold is still very low. Most electricity is contracted through long-term contracts with much lower prices.

External sector: Current account deficit widened in the first quarter

According to the NBU, in the first quarter of 2007 the current account deficit enlarged and reached USD 1.3 bn (5% of GDP). It happened regardless of commodity export growth recovery (32.4% yoy), and should be attributed primarily to a strong rise in commodity imports (32.0% yoy). The additional factor contributing to persistence of the current account deficit was a sharp contraction of a positive balance in service trade down to USD 0.05 bn due to the reduction in gas transit.

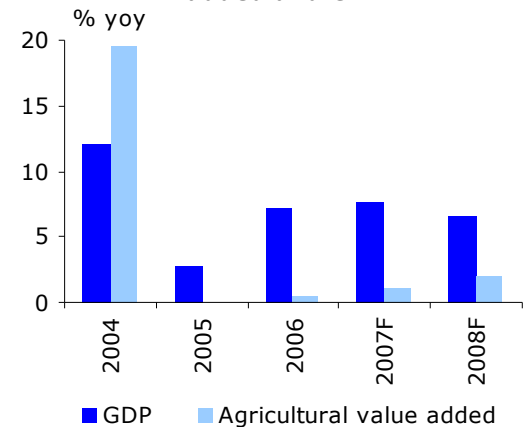
The sustainability of current account deficit is ensured by inflow of long- and medium-term capital. In particular, while long- and medium-term borrowings reached USD 2.7 bn, the net foreign direct investment (FDI) inflow was USD 1.2 bn in the first quarter. These inflows not only compensated the deficit of the current account, but also covered a USD 2.0 bn outflow of short-term capital and increase in international reserves by USD 0.6 bn.

In June 2007 Ukraine and the EU signed a new agreement on import quotas for selected steel products from Ukraine. The agreement can be automatically renewed until Ukraine joins the WTO. The new agreement increases the quota by more than 20% up to 1.32 million tons per year reflecting the accession of Bulgaria and Romania into the EU and increased demand for steel products throughout the EU. Obviously, higher quota will benefit Ukrainian metal exports and positively impact the economy. However, quantitative restrictions on trade will be completely lifted only after Ukraine's WTO accession.

Fiscal policy: Central fiscal revenues were 4.8% above the target in January-May

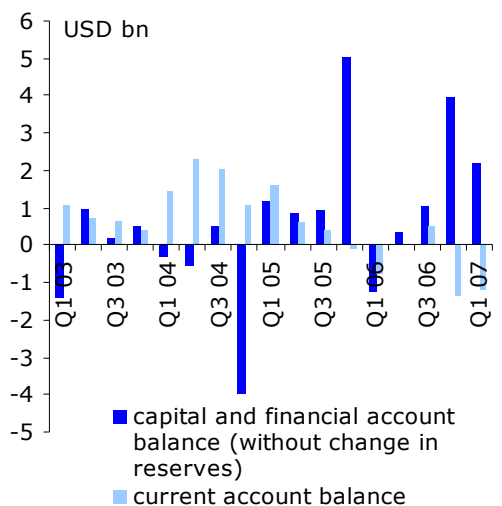
Between January and May the central fiscal revenues were 4.8% above the plan. In particular, strong growth of profits, especially in the export-oriented segment of the economy, allowed exceeding the revenues plan from enterprise profit tax by 9.3%. The VAT revenues were above the target by 2.9% thanks to higher than planned collections of VAT paid on imports (by 9.6%), while the VAT paid on domestic production was 3.9% lower than the target. Profits of state-owned enterprises exceeded the plan by 84.7% and became the additional source of higher than projected fiscal revenues. At the same time, the central fiscal expenditures remained low at 86.4% of the target. The resulting central fiscal surplus was UAH 0.4 bn (0.2% of GDP).

Growth of agricultural value added and GDP



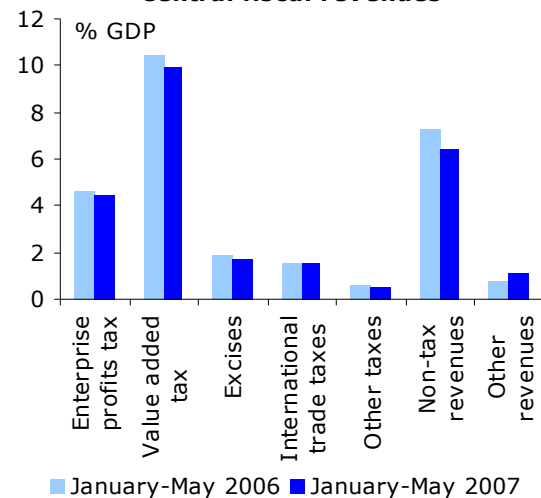
Sources: Derzhkomstat, IER forecast
F - Forecast

Balance of Payments



Source: NBU

Central fiscal revenues



Source: The State Treasury reports

Social policy: Real household incomes grew at 17.5% yoy in the first four months

High consumption growth in early 2007 could be mostly attributable to the growth of real household income. It increased by 17.5% yoy between January and April, though slowing down compared to the same period last year (21.0%). Wage incomes remained a primary source of household income (45.1% of total households' income) and grew at 18.0% yoy in real terms. This was by 10.4 percentage points slower than during the same period of 2006. It can be explained by a less expansionary government policy early this year as well as by a further relocation of funds from wage payments to other needs, likely motivated by increased energy costs. The income received from agricultural and entrepreneurship activities as well as property income grew at 30.0% yoy and 43.6% yoy in real terms, respectively, and greatly contributed to total income growth. Also, the growth rate of real social transfers accelerated and reached 13.1% yoy. The growth rate of household income is likely to speed up later this year due to higher than previously expected increase in minimum wages and pensions.

Monetary policy: Inflation accelerated to 13.0% yoy

Inflation accelerated to 13.0% yoy in June as prices for most plants increased due to expected poor harvest and growth of world prices. While the increase in grain prices was partly constrained due to state regulation and interventions into the market, statistics captured a jump in potato prices due to improved methodology and the absence of state regulation.

Monetary base expanded by 38.4% yoy and money supply grew by 41.9% yoy as NBU continued buying foreign exchange on inter-bank foreign exchange market. Over the second quarter the NBU net purchases for international reserves totalled USD 2.4 bn.

Financial Markets: NBU mandated disclosures on consumer credits

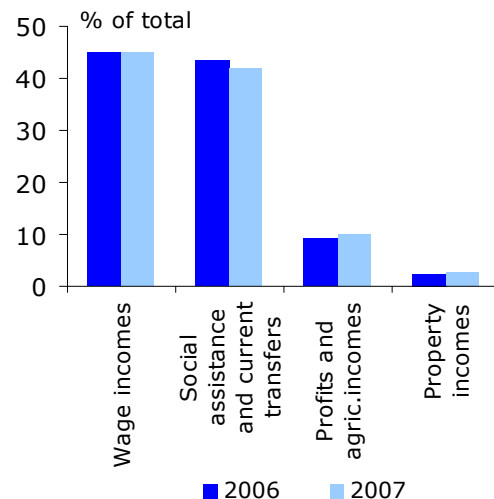
Banking sector. In May the NBU adopted information disclosure rules on real credit costs. According to the rules, banks should inform customers about "real" (effective) annual percentage rate, which reflects all payments related to credit services, and total finance charge. This will simplify comparison of lending rates among different banks. Currently some banks are not following new rules that came into force on June 5 claiming that they didn't have enough time to prepare and that rules have drawbacks. Indeed, some issues are still unclear, such as returns on credit cards and non-coverage of financial intermediaries (other than banks), which may harm competition. Despite these drawbacks, new rules are extremely important for higher transparency and efficiency of consumer loan market. Thus, it is strongly recommended to enforce these rules.

State debt. In June the Ministry of Finance finally entered both domestic and foreign borrowing markets for the first time in this budget year. On June 18 Ukraine placed 5-year eurobonds at 6.385% yield rated by Fitch as BB-. Issue size was reduced from previously planned USD 1.0 bn.

On June 25 the state securities with the maturities between 1.5 and 10 years were offered at the domestic market. However, only securities with 1.5 years maturity were sold for the total amount of UAH 0.8 bn or 21% of the annual plan for the domestic borrowings. Their weighted average yield was 7.12%. Other securities were offered with a yield of 5.7%-7.7%, which was too low to attract investors.

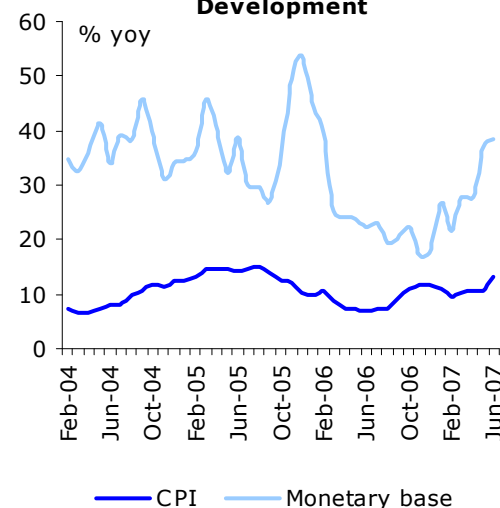
Altogether, in the first half of 2007 the government borrowed around UAH 3.4 bn, while the budget plan for the period was UAH 7.9 bn. Possible reason for low borrowings is that they were not critically important during this period due to the central fiscal surplus. However, low privatisation receipts and lowering tax revenues may urge the government to borrow at a rate indicated in the budget.

Structure of households' incomes, January-April



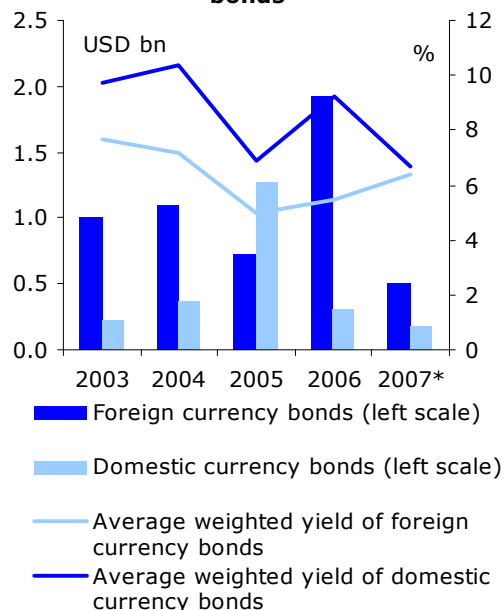
Source: Derzhkomstat

CPI and Monetary Base Development



Source: Derzhkomstat, NBU

Issuance and average yield of state bonds



Source: NBU, the Ministry of Finance, IER estimations

* on July 08, 2007



Economic Trends		Q1 06	Q2 06	Q3 06	Q4 06	Q1 06	Feb	Mar	Apr	May	Jun
GDP growth (real)	% yoy	4.1	6.8	6.9	9.5	...	7.9	7.0	7.6	7.7	...
GDP growth (real)	% yoy cum.	4.1	5.5	6.1	7.1	...	8.6	8.0	7.9	7.9	...
Industrial production (real)	% yoy cum.	0.2	3.6	5.5	6.2	12.5	13.4	12.5	12.5	12.1	...
Agricultural production (real)	% yoy cum.	4.0	3.2	-2.8	0.4	5.0	5.6	5.0	3.4	2.4	...
CPI	% yoy eop	8.6	6.8	9.1	11.6	10.1	9.5	10.1	10.5	10.6	13.0
PPI	% yoy eop	6.5	6.3	10.7	14.4	17.9	16.5	17.9	18.7	20.2	20.6
Exports (USD)***	% yoy cum.	-0.3	4.7	10.7	13.2	32.4	34.5"	33.0"	35.3"
Imports (USD)***	% yoy cum.	24.9	19.7	19.8	22.0	32.0	35.7"	32.2"	35.9"
Merchandise trade balance	USD bn cum.	-1.29	-2.16	-2.93	-5.19	-1.75	-1.38"	-2.22"	-2.98"
Current account	USD bn cum.	-0.74	-0.78	-0.32	-1.62	-1.31	x	x	x	x	x
Current account	% GDP, cum.	-3.7	-1.8	-0.4	-1.5	-5.0	x	x	x	x	x
Gross international reserves	USD bn eop	17.3	17.7	19.1	22.3	23.0	22.4	23.0	23.5	24.5	25.6
Monetary Base	% yoy eop	25.2	22.4	20.3	17.5	27.7	21.7	27.7	27.7	36.9	38.4
Lending rate on UAH credits **	% pa, aop	15.8	15.5	14.6	15.1	14.0	13.9	14.0	14.1	13.4	14.1
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	6.60	6.68	6.81	6.83	6.77

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	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 °	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:

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