



Monthly Economic Monitor Ukraine

- Preliminary election results: five parties will be represented in the new Parliament.
- Real GDP growth decelerated to 7.5% yoy between January and August due to slowdown in agriculture value added.
- The President blocked the privatisation of Odessa By-Port Plant and suspended the sales of oblenezero shares.
- Current account deficit widened to USD 2.0 bn (3.4% GDP) in the first half of the year.
- Central fiscal deficit went down to 1.0% of GDP in August, primarily due to under-execution of expenditures.
- The Draft State Budget 2008: social standards are to be further increased.
- Inflation accelerated to 14.4% yoy in September.
- First Internet transaction took place at the PFTS.

**No.10 (84)
October
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: Five political forces will be represented in new Verkhovna Rada

The electoral campaign was smooth, without serious conflicts and clashes. 62.5% of voters participated in the pre-term parliamentary elections, which is enough to make them legitimate. According to the Central Election Commission, five political forces overcame the 3% threshold. These forces are the Party of Regions with 34.4% of votes, Yuliya Tymoshenko Bloc with 30.7%, Bloc "Our Ukraine – People's Defense" with 14.2%, the Communist Party with 5.4%, and Lytvyn's Bloc with 4.0%. The Socialist Party, the leader of which was the Speaker in the previous convocation of the Parliament, got 2.86% and, thus, would not be represented in the new Parliament. The major surprise of the elections was the increased support of Yuliya Tymoshenko Bloc that received over 8 p.p. more of the votes than in 2006. International observers described the Ukrainian elections as conducted according to the law. Figures announced by various exit polls are very close to the official results, thus confirming their validity. Taking into account the small gap between the two leading political forces, structure and stability of the future coalition remains far from sure.

Real economy: Real GDP growth slowed to 7.5% yoy between January and August

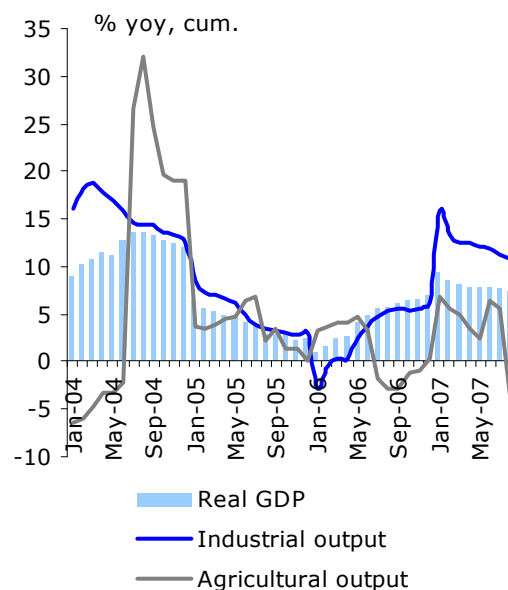
In line with expectations, in August the value added in agriculture dropped decelerating the growth of real GDP. According to the Derzhkomstat, cumulatively in the eight months of the year real GDP grew by 7.5% yoy that is 0.2 p.p. lower than in the previous period. The declined production in agriculture was partly counterweighted by acceleration of services growth, in particular in trade and transport. Also, the growth of value added in production and distribution of electricity, gas, and water turned positive, backed by continued economic expansion.

In the first eight months of the year industrial output grew by 10.9% yoy slowing down due to the statistical base effect. The main contributors to industrial growth were machine building, metal production, and food industry.

Sectoral trends: Privatization plan for 2007 is unlikely to be fulfilled

Privatization. In September the President suspended the privatisation of Odessa By-Port Plant and shares in six oblenezero scheduled for this year. In the case with Odessa By-Port Plant, the President explained his decision by the need to protect economic and ecological security of the country, as the tender conditions were non-competitive, and referred the case to the Constitutional Court. The ban on sales of oblenezero shares was justified by the possible bankruptcy and worsening of the financial state of the NJSC "Energy

Real growth rates of GDP, industrial and agricultural output



Source: Derzhkomstat

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Company of Ukraine". However another possible motive for the suspension is the desire to prevent non-transparent sales of companies in the period of changing government. As of September, the privatization plan was fulfilled at only 15% (UAH 1.6 bn out of the planned UAH 10.6 bn). Such suspension could lead to a non-execution of the current privatization plan, forcing the Government to borrow to cover the budget deficit.

Agriculture. The government prolonged the existing prohibitive quota on grain export until November 1 and introduced a wider quota at 1.2 m tons for the period between November 1, 2007 and March 31, 2008. The quota is distributed among corn, barley, feed wheat of 6th class, and rye. The measure was taken to deal with the consequences of poor grain harvest. Although the widening of export quota is a positive step, the ad-hoc state regulations of the market hurt producers and thus investment growth, damaging agricultural potential of Ukraine.

Energy. Auctions selling mining and mineral prospecting licenses were stopped in September as the President suspended the relevant Decree of the Cabinet of Ministers issued in April 2007. The moratorium was set after the NSC "Ukrnafta" reported widespread abuses during the auctions using loopholes in sales procedure. To ensure a further development of the sector, a prompt revision of auction procedures for mining licensing is required.

Infrastructure. The President adopted the Concept on improvement of natural monopolies state regulation. It foresees the mandatory creation of independent regulatory bodies for natural monopolies. The same issues are covered by the Law "On natural monopolies", though the Concept extends the law, making such regulators more transparent and providing them with additional authority to determine price-setting procedures, grant licenses, and settle the disputes. Though, to improve natural monopolies regulatory policy, the key issue is due implementation of a legislation.

External sector: Current account deficit widened to USD 2.0 bn between January and June 2007

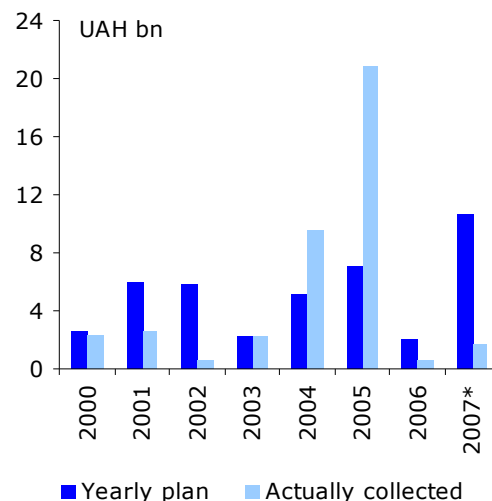
According to the NBU, in the first half of 2007 current account deficit widened to USD 2.0 bn (3.4% GDP) compared to USD 0.8 bn (1.7% of GDP) a year ago. The growth rate of imports exceeded growth rates of exports both for goods and services. Therefore, commodity trade deficit reached USD 3.2 bn, while the positive balance of service trade began shrinking and amounted to USD 0.5 bn. Commodity export growth relied on favourable world prices for Ukrainian products, early harvest and no quota for agricultural products in June, while service exports decelerated due to reduction of gas transit volumes. High domestic demand guaranteed growth of imports of goods and services.

Current account deficit sustainability was ensured by positive financial account amounting to USD 5.8 bn compared to USD 0.9 bn deficit in the same period of 2006. Net inflow of foreign direct investments were USD 3.3 bn, with financial sector attracting 35% of the total. Also, net inflow of medium- and long-term credits and bonds reached USD 5.3 bn. These inflows compensated the outflow of short-term capital, covered current account deficit and increased international reserves.

Fiscal policy: Central fiscal deficit went down to 1.0 % of GDP in August

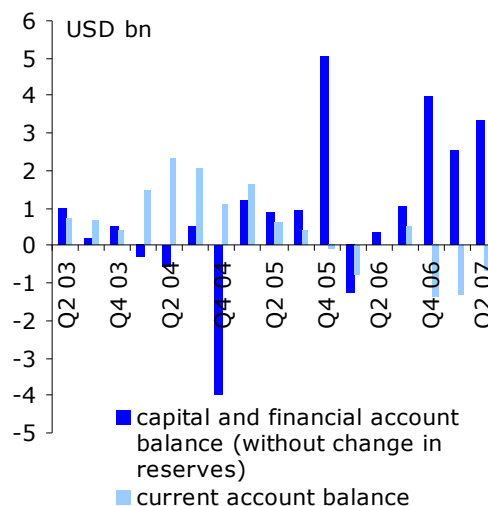
Between January and August 2007 the central fiscal revenues were above the plan by 2.8%, backed by the higher than projected enterprise profit tax revenues. For the first time since the beginning of the year the VAT revenues underperformed by 1.6% due to low collections of the VAT on domestic production. In addition, excise revenues also remained below the target. The central fiscal expenditures remained below the target at 94.5%. As a result, the central fiscal deficit shrank to UAH 4.0 bn (1.0% GDP). The deficit was financed mainly by funds accumulated on treasury accounts.

Privatisation Receipts



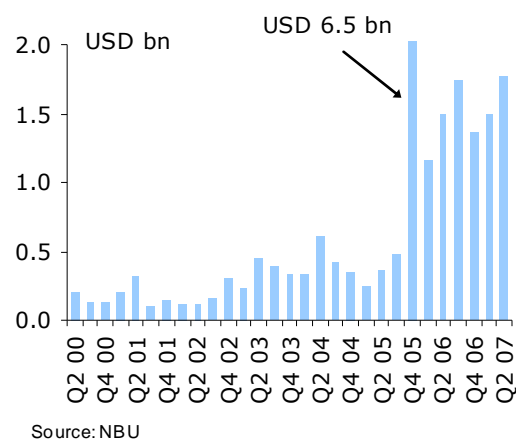
* as of September 24, 2007
Source: State treasury of Ukraine

Balance of Payments



Source: NBU

Net Foreign Direct Investments



Source: NBU

The Government prepared draft State Budget for 2008. The central fiscal revenues are set at UAH 191.1 bn (23.6% of GDP), while expenditures at UAH 211.9 bn (26.2% of GDP). The budget deficit is foreseen at 2.3% of GDP. As the Tax Code was not passed by the Parliament, no radical tax changes are expected in 2008. Among possible tax innovations are tax privileges for investment projects and 5-year tax vacations for small businesses. On the expenditure side, both social and capital spending are planned to increase. However, if the Government is changed in next months, it is quite likely that the draft Budget will be considerably revised.

Social policy: Social standards are to be further increased in 2008

The draft State Budget 2008 foresees further increase in social standards compatible with growth in 2007. The subsistence minimum and minimum pension linked to it are to be raised gradually during the year. Besides, the compensation for working persons, who have the right to claim pension but don't use it, is to be increased from 1% to 2% of due pension level for each year worked above the required working record. This would contribute to more differentiation of pensions that diminished after rapid minimum pension increase in 2004. Also, payments to low-income families and families with children are planned to be increased. The Draft foresees increased childbirth grants in the range between UAH 11,700 to UAH 50,000, depending on the number of children.

The monthly minimum wage will be increased from UAH 460 in December 2007 to UAH 565 in October 2008 reaching 90.3% of the subsistence minimum for working able individuals. According to the legislation from January 1, 2009 the minimum wage will be equal to the subsistence minimum. Higher minimum wage will cause the growth of wages in public sector based on the Unified Tariff Scale. However, this draft may be reconsidered after the formation of a new government.

Monetary policy: Inflation accelerated to 14.4% yoy in September

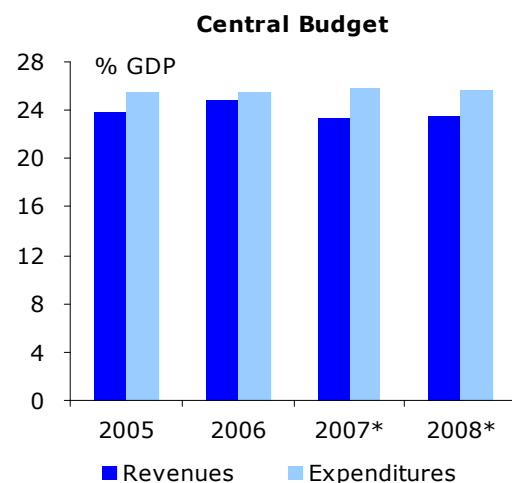
Growth of consumer prices accelerated slightly to 14.4%. Livestock product prices continued to grow due to high external and internal demand as well as increasing feedstock and utility costs. Short-term inflation outlook depends on developments in price regulation after elections. Current government intends to increase bureaucratic interference in the pricing. At the same time, current monetary expansion and generous social spending can add further demand-side pressure on prices.

Monetary base increased by 50.6% yoy and money supply grew at 48.4% yoy as the NBU bought USD 0.8 bn into international reserves and the government used UAH 4.0 bn from treasury accounts. However, in September the NBU partially sterilized its interventions, thus limiting expansion of money supply.

Financial Markets: First Internet transaction took place at stock market

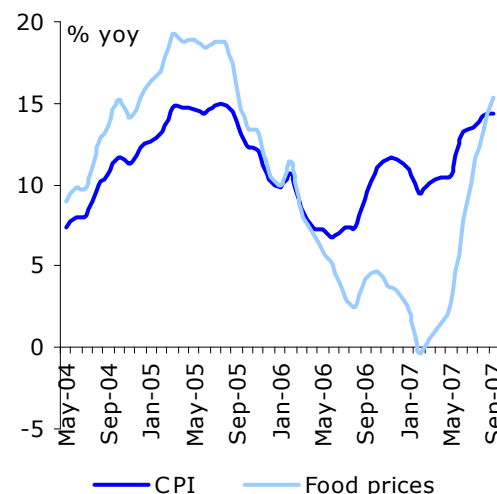
Stock market. In September the first Internet transaction was held at the PFTS. This new way of trading could increase trade turnover and market liquidity. There was another attempt before to modernize trading process at stock market by implementing an order driven market. Nevertheless, stock market participants did not rush to use the technology, possibly due to inability to correct bargain conditions allowed only at quote driven market. So there is a chance that market traders once again will not be ready for innovation.

State debt. The situation in September resembled that of previous months. The government followed its strategy of cheap borrowings. The Ministry of Finance again sold three- and four-year treasury bonds with the same yield of 6.6% p.a. and 6.4% p.a. respectively, while for the longer term state bonds the yield was left unattractive at 5.0%-5.1% p.a.



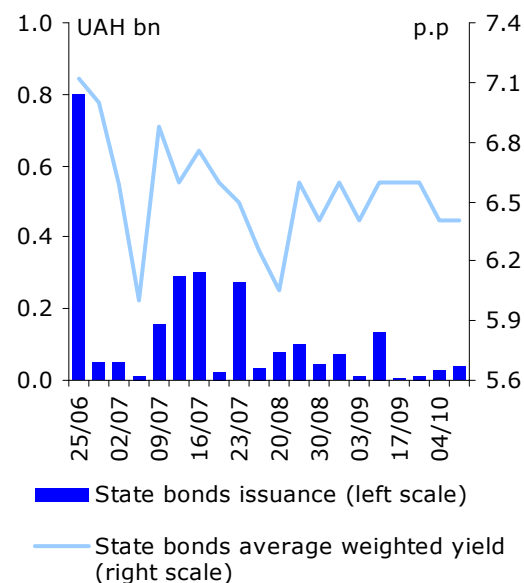
Sources: State Treasury, Budget Law 2007, Draft Budget Law 2008

Food prices and CPI development



Source: Derzhcomstat

Issuance and Average Yield of State Domestic Bonds in 2007



Source: NBU, the Ministry of Finance, IER estimations



Economic Trends		Q1 06	Q2 06	Q3 06	Q4 06	Q1 07	Q2 07	Jun	Jul	Aug	Sep
GDP growth (real)	% yoy	4.1	6.8	6.9	9.5	8.0	7.9	7.8	7.2	5.8	...
GDP growth (real)	% yoy cum.	4.1	5.5	6.1	7.1	8.0	8.0	7.9	7.7	7.5	...
Industrial production (real)	% yoy cum.	0.2	3.6	5.5	6.2	12.5	11.8	11.8	11.2	10.9	...
Agricultural production (real)	% yoy cum.	4.0	3.2	-2.8	0.4	5.0	6.3	6.3	5.5	-3.4	...
CPI	% yoy eop	8.6	6.8	9.1	11.6	10.1	13.0	13.0	13.5	14.2	14.4
PPI	% yoy eop	6.5	6.3	10.7	14.4	17.9	20.6	20.6	21.2	20.4	19.6
Exports (USD)***	% yoy cum.	-0.3	4.7	10.7	13.2	32.4	32.4	32.9"	31.9"
Imports (USD)***	% yoy cum.	24.9	19.7	19.8	22.0	32.0	33.2	33.8"	35.0"
Merchandise trade balance	USD bn cum.	-1.29	-2.16	-2.93	-5.19	-1.75	-3.20	-4.19"	-5.25"
Current account	USD bn cum.	-0.74	-0.78	-0.32	-1.62	-1.31	-2.00	x	x	x	x
Current account	% GDP, cum.	-3.7	-1.8	-0.4	-1.5	-5.0	-3.4	x	x	x	x
Gross international reserves	USD bn eop	17.3	17.7	19.1	22.3	22.9	25.9	25.9	27.3	28.9	30.6
Monetary Base	% yoy eop	25.2	22.4	20.3	17.5	27.7	38.4	38.4	40.6	47.2	50.6
Lending rate on UAH credits **	% pa, aop	15.8	15.5	14.6	15.1	14.0	14.1	14.1	13.9	13.3	13.8
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	6.77	6.90	6.87	7.16

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