



Monthly Economic Monitor Ukraine

- A new government has been formed with Yulia Tymoshenko appointed as Prime Minister.
- Real GDP growth decelerated to 7.2% yoy between January and November.
- Price of the imported gas faced 38% increase and was fixed at USD 179.5 per tcm for 2008, while the cost of gas transit was increased by 6% only.
- Current account deficit reached USD 2.2 bn between January and September but is still covered by high capital inflows.
- Central fiscal deficit is planned at 2.1% of GDP in 2008 and is supposed to be financed at the expense of both borrowings and privatisation receipts.
- The unemployment rate declined to 6.2% in the third quarter of 2007.
- Inflation in December accelerated to 16.6% yoy.

No.1 (87)
January
2008

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: Yulia Tymoshenko is the new Prime Minister

On December 18 Yulia Tymoshenko was finally approved as Ukraine's new Prime Minister by a minimal majority of 227 votes, putting an end to almost three months of uncertainty that followed the early parliamentary election at the end of September. The Verkhovna Rada has also appointed a new coalition Government with eleven ministers from Yulia Tymoshenko Bloc, eleven from pro-presidential "Our Ukraine-People's Defence" Bloc, and two nominated by the President. In the Verkhovna Rada the non-coalition factions – Party of Regions, Communists, and Lytvyn Bloc – received control over 13 out of 28 parliamentary committees. Taking into account a tiny majority of coalition in the Parliament, the most legislative actions will have to be supported by the opposition to pass, limiting the policymaking ability of the new Government.

In December the World Bank Executive Board approved the Second Development Policy Loan (DPL-II) for Ukraine at USD 300 m. This approval followed endorsement of a new Country Partnership Strategy for Ukraine covering the period 2008 to 2011. The DPL II is the second loan in a program to support reforms in three core thematic areas: improving the investment climate; creating the fiscal space for greater public investment through more efficient public financial management; and improving the public service delivery and greater social inclusion. The loan is expected to support economic reforms in Ukraine.

Real economy: Real GDP grew at 7.2% yoy between January and November

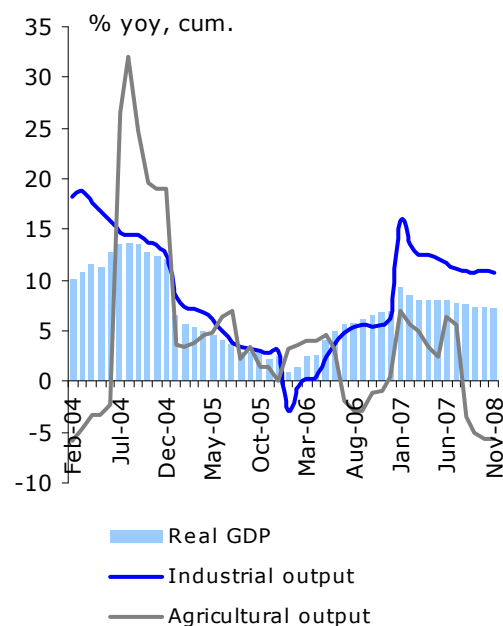
The economic growth in the country remained high despite significant political uncertainty, increased energy prices and international financial crisis. According to Derzhkomstat, between January and November the real GDP grew by 7.2% yoy, thus only slightly decelerating compared to the previous period. The reduction of the value added in agriculture stabilized at around 5% yoy after the conclusion of the harvesting season. This drop was sufficiently counterweighted by strong growth in trades and manufacturing.

In the first eleven months of the year industrial output increased by 10.7% yoy mainly due to machine building, in particular production of vehicles. Machine building was supported by households demand on durables, including passenger cars. Modernization needs of enterprises also stimulated demand for investment goods.

Sectoral trends: Price of the imported gas on the border with Russia increased by 38% for 2008

Energy. In the second half of December an agreement between Ukraine and Russian "Gazprom" on gas deliveries was signed, raising the gas price at the Ukrainian-Russian border from USD 130 per

Real growth rates of GDP, industrial and agricultural output



Source: Derzhkomstat

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thousand cubic meters (tcm) in 2007 to USD 179.5 per tcm in 2008. The price for Russian gas transit through the territory of Ukraine was raised from USD 1.6 per tcm per 100 km to USD 1.7 per tcm. The increase in imported gas price was partially caused by the higher price for Turkmen gas and anticipated increase in Kazakh and Uzbek gas prices. The new price is expected to adversely influence trade balance, enterprise margins, and overall industrial dynamics. However, if high world steel and chemicals prices are maintained, the impact will not be dramatic enough to substantially undermine the business activities of major Ukrainian gas consumers.

Land market. The Verkhovna Rada further prolonged the land moratorium by the Budget Law 2008 since appropriate legislation on the land market has not been adopted yet. Originally the moratorium was applied provisionally till 2005, but was prolonged several times. This situation creates shady schemes for land sales and constrains efficiency of Ukrainian agriculture.

Privatization. In 2007 the privatization plan was fulfilled by only 23% from the declared amount of UAH 10.6 bn. The Budget 2008 envisages privatization receipts at UAH 8.9 bn (0.96% of GDP). Besides, it is planned to get additional privatization revenues at approximately UAH 12 bn, which are to be directed for compensating the devalued savings at the Soviet "Sberbank". Most likely, the list of objects for privatization would contain some "blue chips", such as Ukrtelecom and Odessa by-port plant that were not sold in 2006-2007. Besides, it is planned to sell land lots under the objects for privatization. But the absence of a new privatization program and poor privatization record of previous years makes the year 2008-plan look a bit risky.

Telecommunications. In December the Cabinet of Ministers (CMU) cancelled a number of its earlier Decrees, implementation of which was postponed by the President. In particular, a decree on re-subordination of the National Commission for the Regulation of Communications (NCRC) to the CMU that created the prerequisites for government interference undermining regulator's independence. It is expected that the cessation of re-subordination procedure should lead to more stability and independency of the regulator, but only if this decision is final and definitive.

External sector: Growing current account deficit is still covered by capital inflows

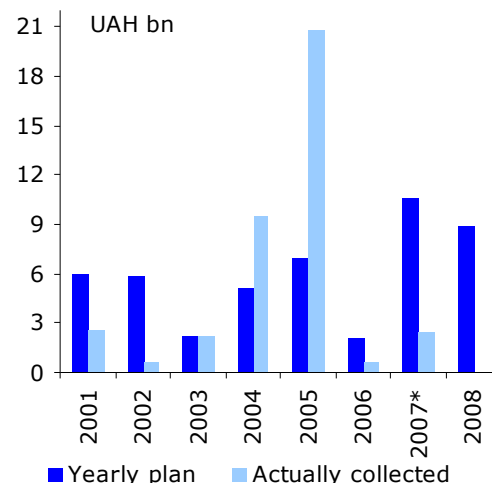
According to the NBU, in the nine months of 2007 the current account deficit reached USD 2.2 bn (2.2% of GDP). The sustainability of current account deficit was ensured by inflow of long- and medium-term capital. The net inflow of foreign direct investment (FDI) was USD 7.1 bn between January and September. The most attractive sectors for the FDI remained services, in particular financial sector (34.7% of the inflow), real estate transactions, and business services.

According to Derzhkomstat, between January and October 2007 commodity export grew by 27.4% yoy in dollar terms, while import faced 32.9% yoy growth. Despite commodity export growth recovery, commodity trade deficit was USD 8.2 bn compared to USD 4.9 bn in the same period of 2006. High export growth was maintained to the large extent by growth in exports of ferrous metals and machinery, while favourable conditions on the world vegetable oil market contributed to the growth of this category of agricultural exports. Volume of imports increased supported by growth of mineral and chemical products together with vehicles and associated transport equipment.

Fiscal policy: The central fiscal deficit is planned at 2.1% of GDP in 2008

On December 28 Parliament approved the State Budget Law for 2008, submitted by the Government of Yulia Tymoshenko. According to the Law, the central fiscal revenues and expenditures are planned at UAH 215.4 bn (24.2% of GDP) and UAH 232.4 bn (26.1% of GDP)

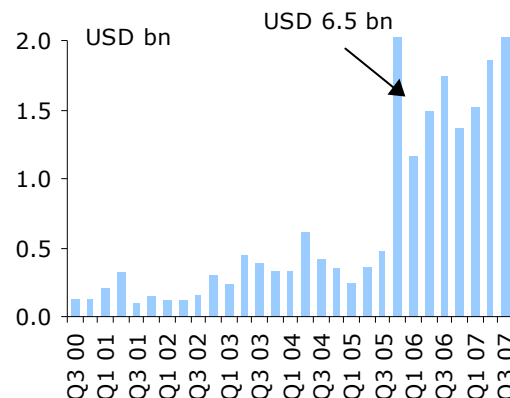
Privatisation Revenues



* as of December 24, 2007

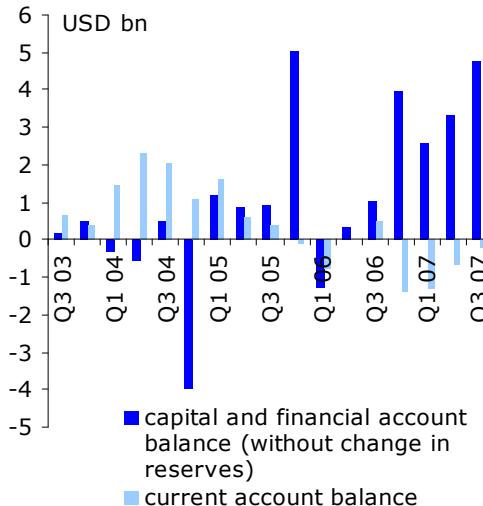
Source: State treasury of Ukraine, SPFU

Net Foreign Direct Investments



Source: NBU

Balance of payments



Source: NBU

respectively. The central fiscal deficit is envisaged at UAH 18.8 bn or 2.1% of GDP. It is to be financed at the expense of privatisation receipts and borrowings, with domestic and foreign borrowings at almost equal proportions.

Between January and November 2007, central fiscal revenues were executed at 101.8% of the plan due to strong enterprise profit tax collections. The execution of central fiscal expenditures by the end of the year reached 98.3% of the plan. The financing of social payments, education and public order had the highest rate of execution. The central fiscal deficit slightly reduced and amounted UAH 6.9 bn (1.1% of GDP).

Social policy: Unemployment continues to decline

The Derzhkomstat reports further improvement of situation on the labour market thanks to strong economic growth in the country. In the third quarter of 2007 the unemployment rate (ILO methodology) fell to 6.2% of working able population, which is 2 percentage points lower than a year ago. This trend was accompanied by a constant increase in wages.

The Budget Law for 2008 passed in the end of December kept the levels of social standards proposed in the draft State Budget Law, prepared by the Government headed by Victor Yanukovitch. Also, the raise in childbirth grants with the differentiation of their size depending on the number of children in the family (UAH 12400 for the first child, UAH 25000 for the second, and UAH 50000 for the third and the next child) was retained. Thus, formally social standards are expected to increase in real terms. At the same time, the actual size of social assistance to low-income households, disabled individuals, and other vulnerable groups will remain low, as these payments are defined at the amount of guaranteed levels of subsistence minimum.

Monetary policy: Inflation moves up to 16.6% in December

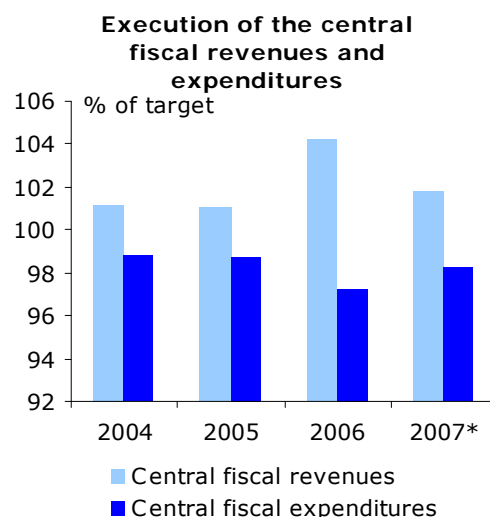
Consumer price inflation accelerated to 16.6% yoy in December. Food prices continued to grow as high seasonal demand allowed producers to pass growing energy and labour costs on consumers. Statistical base effect also exerted upward pressure on the CPI. In the beginning of 2008 new utility price increases and high inflation expectations are expected to keep inflation pressure intact.

Monetary base grew 46.0% yoy and money supply grew 52.2% yoy in December as government closed books for 2007 budget year. The NBU net sales of the foreign currency in the amount of USD 179 m and aggressive sales of deposit certificates also influenced monetary conditions as the NBU tried to limit inflationary pressure managing excessive liquidity.

Financial markets: Interbank exchange rate temporarily moved out of its unofficial band

Exchange rate. In December USD/UAH inter-bank exchange rate was close to the upper limit of the *de facto* exchange rate band of 5.00-5.06 UAH per USD. On several occasions NBU allowed exchange rate to fluctuate in 5.06-5.07 range for considerable time before intervening. Slight depreciation of hryvnia in December is likely caused by seasonal factors such as closing of contracts at the year-end. The NBU explained its reluctance to intervene on the market citing temporary spikes in demand.

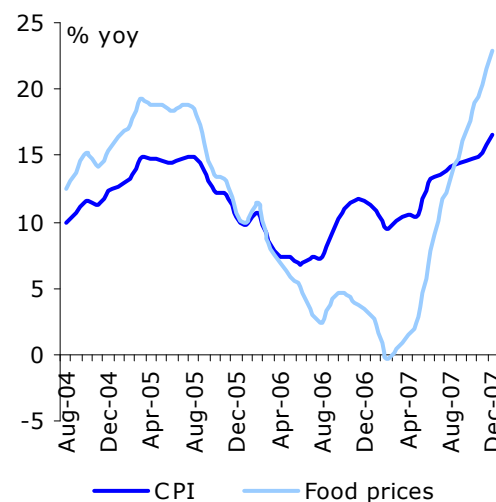
State debt. In December the government continued offering three-four-year bonds with 6.3% – 6.4% yield p.a. Despite relatively low yield, the Ministry of Finance was able to attract UAH 20.3 m this month. As a result, in 2007 the government fulfilled 90% of the plan for domestic borrowings mainly due to stable demand for state securities from state banks and non-residents.



* As of December 1, 2007

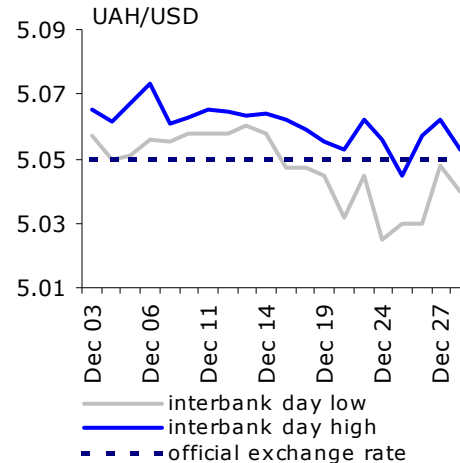
Source: State Treasury reports

Food prices and CPI development



Source: Derzhkomstat

Exchange rate



Source: Reuters Investor



Economic Trends		Q2 06	Q3 06	Q4 06	Q1 07	Q2 07	Q3 07	Sep	Oct	Nov	Dec
GDP growth (real)	% yoy	6.8	6.9	9.5	8.0	7.9	6.4	6.2	7.0	6.9	...
GDP growth (real)	% yoy cum.	5.5	6.1	7.1	8.0	7.9	7.3	7.3	7.3	7.2	...
Industrial production (real)	% yoy cum.	3.6	5.5	6.2	12.5	11.8	10.7	10.7	11.0	10.7	...
Agricultural production (real)	% yoy cum.	3.2	-2.8	0.4	5.0	6.3	-5.1	-5.1	-5.7	-5.7	...
CPI	% yoy eop	6.8	9.1	11.6	10.1	13.0	14.4	14.4	14.8	15.2	16.6
PPI	% yoy eop	6.3	10.7	14.4	17.9	20.6	19.6	19.6	19.7	20.0	23.3
Exports (USD)***	% yoy cum.	4.7	10.7	13.2	32.4	32.4	27.3	25.7"	27.4"
Imports (USD)***	% yoy cum.	19.7	19.8	22.0	32.0	33.2	31.5	31.2"	32.9"
Merchandise trade balance	USD bn cum.	-2.16	-2.93	-5.19	-1.75	-3.18	-5.38	-3.71"	-8.22"
Current account	USD bn cum.	-0.78	-0.32	-1.62	-1.31	-2.00	-2.15	x	x	x	x
Current account	% GDP, cum.	-1.8	-0.4	-1.5	-5.0	-3.4	-2.2	x	x	x	x
Gross international reserves	USD bn eop	17.7	19.1	22.3	22.9	25.9	30.6	30.6	31.7	32.8	32.5
Monetary Base	% yoy eop	22.4	20.3	17.5	27.7	38.4	50.6	50.6	48.5	48.4	46.0
Lending rate on UAH credits **	% pa, aop	15.5	14.6	15.1	14.0	13.9	13.7	13.8	13.7	14.0	14.4
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	6.34	6.43	6.51	6.62	6.81	6.93	7.00	7.18	7.40	7.34

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