



Monthly Economic Monitor Ukraine

- The work of the Verkhovna Rada has been blocked by the opposition.
- Real GDP increased by 7.3% yoy in 2007, maintaining the growth rate of the previous year.
- The Government approved the list of enterprises for privatisation in 2008.
- The WTO adopted Ukraine's "accession package", thereby successfully completing the fourteen-year negotiations.
- The central fiscal deficit reached 1.7% of GDP in 2007 and was financed from the Treasury account and through the state borrowings.
- The Government started the payments of compensations to the owners of the devalued savings in the Soviet Sberbank.
- Inflation in January accelerated to 19.4% yoy.
- Hryvnia faced depreciation pressure against US dollar in January.

No.2 (88)
February
2008

Population: 46.4 m
Industry/GDP: 26%
Agriculture/GDP: 8%
Investment/GDP: 24%
Exports to: Russia 23%, EU 28%
Imports from: Russia 31%, EU 35%

Politics: The work of the Parliament was blocked by the Party of Regions

The work of the Verkhovna Rada was blocked by oppositional Party of Regions, as the new wave of confrontation between the opposition and coalition surged. The disagreement arose in response to the Letter of the President, Prime Minister and Speaker of the Parliament to the NATO Secretary-General expressing Ukraine's aspiration to join the Membership Action Plan. The Party of Regions asserted that this step should have been preceded by the consultation with the Verkhovna Rada, while Ukraine's membership in NATO has to be decided on the national referendum.

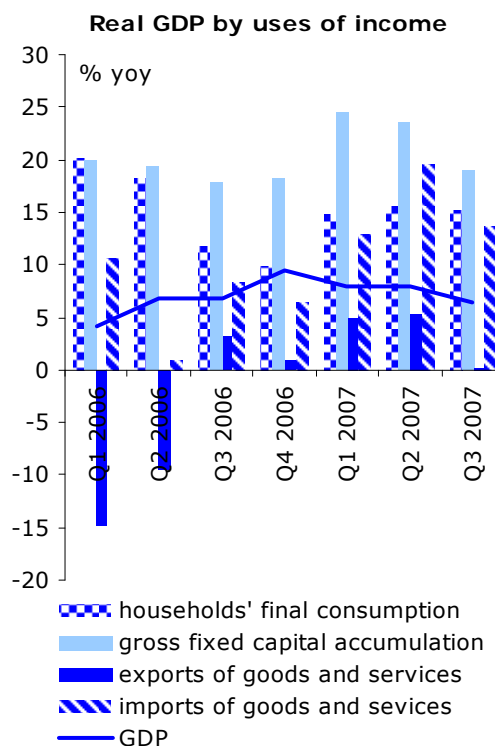
In January 2008 Prime Minister of Ukraine Yulia Tymoshenko made her first foreign visit to Brussels to meet the EU leaders. The two parties noted substantial progress achieved in the negotiations on the new enhanced agreement between the EU and Ukraine.

Real economy: Real GDP grew at 7.3% yoy in 2007

Economic growth remained high in Ukraine in 2007 despite political turmoil and external shocks, namely almost a 40% increase in imported gas price and international financial crisis. According to the preliminary estimates of the Derzhkomstat, real GDP grew by 7.3% in 2007, maintaining the growth rate of the previous year. Strong domestic demand remained the key driving force for the GDP growth. In the first nine months of the year real household final consumption increased by 15.2% yoy showing no signs of slowdown despite accelerated inflation. Also, investments remained high with real gross fixed capital accumulation growth at 21.8% yoy. High domestic demand was partially satisfied by higher supply of foreign products as real imports of goods and services increased by 15.4% yoy, while real exports grew by 3.1% yoy. On supply side, trades and industry contributed the most to the real GDP growth. Industrial output increased by 10.2% yoy in 2007 compared to 6.2% yoy rise a year ago. The largest contributors to industrial growth remained machine building, metal production and food industry.

Sectoral trends: The Government approved the list of enterprises for privatisation in 2008

Privatisation. The Government approved the list of enterprises for primary sale this year. The list contains more than twenty enterprises, including Ukrtelecom, Odessa by-port plant and six oblenergos. In particular, the Government reconsidered the decision of the previous Cabinet of Ministers to keep the control stake of Ukrtelecom in state property, and now plans to sell 68% share as compared to 38% stipulated in previous year plan. This decision makes Ukrtelecom more attractive acquisition for potential investors.



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Energy. In January, the National Electricity Regulatory Commission (NERC) issued a decree limiting gas volumes licensed for delivery to final consumers by monopolistic importer CJSC "UkrGasEnergy" to 5.04 bn cubic meters per year. The decision was based on anti-monopoly clause, according to which affiliated companies cannot control more than 35% of gas distribution market. The company was supposed to sell the remaining gas to independent traders. The decision would improve competitive environment on gas distribution market since more players would be involved into the activity. However, the court suspended the NERC decision pending the outcome of the trial.

Agriculture. In January the Ministry of Economy began accepting applications for grain export quota. So far, exporters applied to export 2.4 m tonnes of the grain, which is twice more than existing quota introduced in September 2007 for the marketing year 2007/2008. Grain export potential for the year is estimated at 4-6 m tonnes, and existing quotas could be safely increased. Current quotas at 1.2 m tons were distributed at the beginning of February. Meanwhile, the Derzhkomstat reported on grain exports through Ukraine's border, which could be explained by export contracts signed before the quota introduction.

External sector: WTO entry negotiations are complete

In January the WTO Working Party finally adopted Ukraine's "accession package", thereby successfully completing the fourteen-year negotiations. The package consists of a Working Party report, market access schedules for goods and services, draft General Council decision and draft Protocol of Accession. It was put forward to the WTO General Council for consideration and approved by the Council at the meeting on 5 February 2008. Now, the Verkhovna Rada will have to ratify this package by July 4, 2008. Ukraine will officially become a member 30 days after. Since the launch of negotiations in 1993 Ukraine has already implemented the most of the required legislative and regulatory changes. Thus, no major changes in legislation are expected, except for agro-food sector.

According to the Derzhkomstat, between January and November 2007 merchandise exports growth (27.9% yoy) lagged behind that of imports (34.2% yoy). As a result, merchandise trade deficit reached USD 9.6 bn from USD 5.5 bn in the same period of 2006. The most traded commodities remained the same: ferrous metals and machinery for exports, and vehicles, mineral and chemical products for imports. The role of the EU as trading partner increases: member countries account for 28.4% of the total exports and 36.6% of imports. The share of the CIS also grows, they account for 38.0% of exports and 42.6% of imports, with Russia being the main country - trade partner for Ukraine.

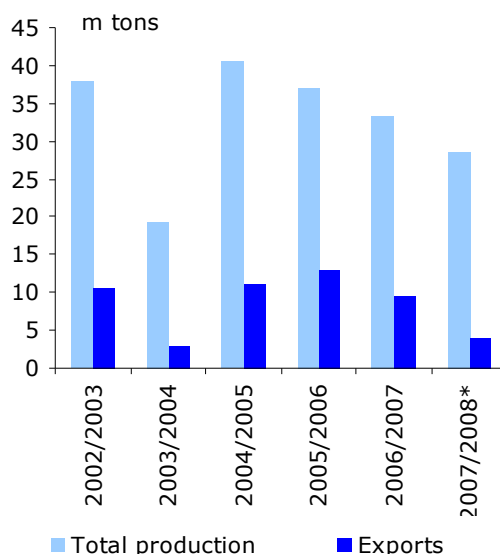
Fiscal policy: The central fiscal deficit reached 1.7% of GDP in 2007

In 2007 the central fiscal revenues were executed at 100.5% of the plan due to high enterprise profit tax (EPT) revenues. Moreover, extra revenues were received from custom duties and the profits of state-owned enterprises. At the same time, the VAT revenues were 7.6% below the target due to lower than planned collections of VAT on domestic consumption. The central fiscal expenditures remained under-executed being at 96.0% of the plan. Resulting central fiscal deficit amounted UAH 11.4 bn (1.7% of GDP) and was financed from the Unified treasury account and through state borrowings.

Social policy: The government launched the payment of compensations to the owner of the devalued savings in the Soviet Sberbank

In January the state bank "Oschadbank" received USD 400 m from the Ministry of Finance for compensation to the owners of the devalued savings in the Soviet Sberbank. At the first stage, each depositor is entitled to up to UAH 1000. As of January 30, compensation was transferred to more than 1 m accounts. Overall,

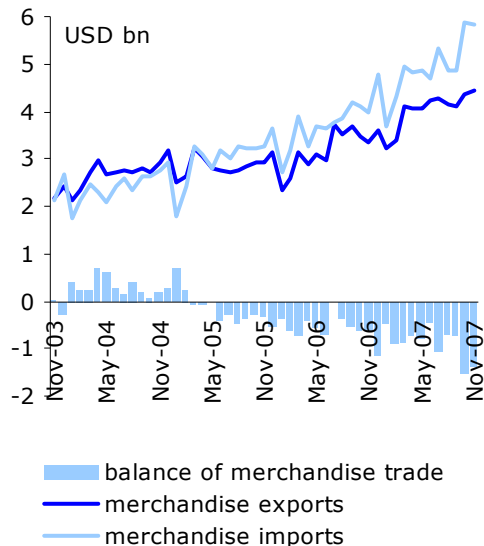
Production and exports of grains and pulses in 2002-2008



Source: USDA

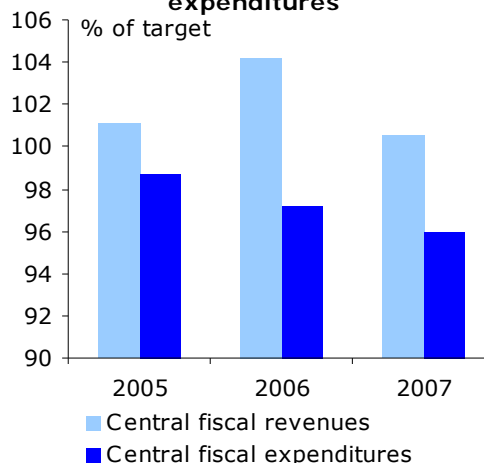
Note: * exports forecast

Merchandise Trade



Source: Derzhkomstat

Execution of the central fiscal revenues and expenditures



Source: State Treasury reports

the State Budget Law 2008 foresees compensation in the amount of USD 1.2 bn. The repayment is supposed to be smoothed in time in order not to create significant inflationary pressure on the economy.

In January the Government approved the balanced budget of the Pension Fund. The Fund's expenditures are planned at UAH 141.2 bn, which is 41.3% higher than in 2007. Own revenues of the Pension Fund are envisaged at UAH 101.8 bn. The central fiscal transfer remains high at UAH 34.8 bn, from which UAH 20.9 bn are foreseen for financing different state pension programs, UAH 12.7 bn for paying pensions to retired military and judges, and UAH 1.2 bn to compensate the Pension Fund for lower contributions from participants of the fixed agricultural tax scheme. UAH 4.6 bn came from the previous year surplus. For 2008 the Government set maximum pension at 12 minimum pensions (UAH 5640 as of January 1, 2008). Though, the pensions of retired members of the Cabinet of Ministers, people deputies, and prosecutors were capped at UAH 10000. Such limits, though a positive step, are still high as compared to the average pension expected to reach UAH 808 by the end of 2008.

Monetary policy: Inflation accelerated to 19.4 % in January

In January inflation accelerated to 19.4% yoy. Food prices continued to grow as strong households' demand allowed producers to pass growing energy and labour costs on consumers. Statistical base effect, transport and utility price increases and high inflation expectations also exerted upward pressure on the CPI.

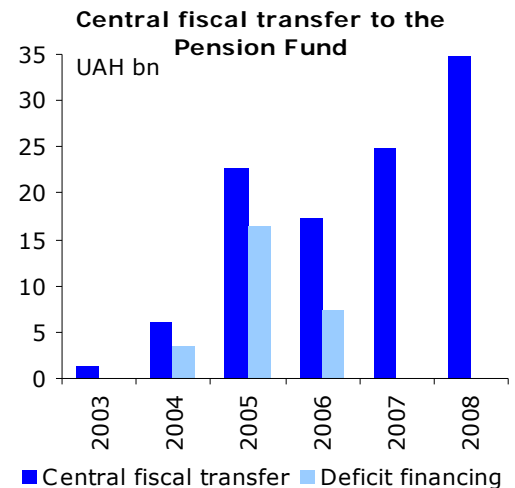
Monetary base increased by 42.7% yoy and money supply by 53.0% yoy in January. The growth of monetary aggregates somewhat decelerated because of net sales of foreign currency by the NBU in the amount of USD 409 m and accumulation of government funds on the NBU account. Also, in January the NBU increased discount rate from 8% to 10%, signalling about further tightening of monetary policy as a part of anti-inflationary campaign.

Financial markets: Hryvnia faces depreciation pressure against US dollar

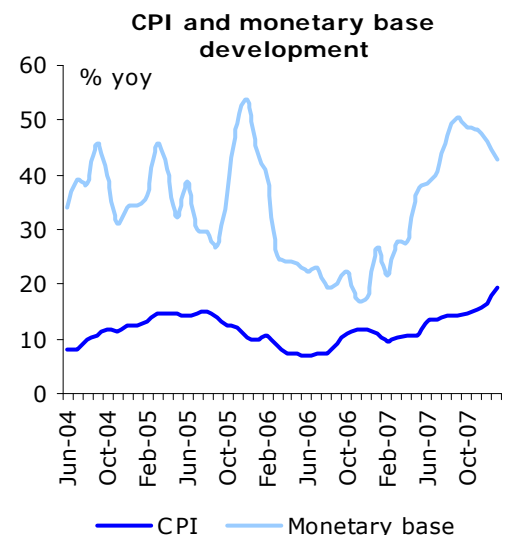
Exchange rate. In January UAH/USD inter-bank exchange rate fluctuated in 5.05-5.08 USD per UAH range as foreign currency demand often exceeded the supply. While the NBU sold dollars for 5.06 UAH per USD, its interventions didn't satisfy all demand thus pushing the exchange rate over 5.06 mark. High demand for the US dollars could be attributed to higher payments for imported gas.

Banking. In 2007 the banking sector growth was among the highest in the economy. According to the NBU, in 2007 commercial banks earned UAH 7.1 bn compared to UAH 4.6 bn in 2006. Bank assets grew by 75.9% yoy mostly due to rapid increase in lending. Credit outstanding increased by 80.3%, with credits to households growing at higher rates (97.6% yoy) than credits to legal entities (64.7% yoy). The credit expansion was to the large extent financed by foreign borrowings. The quality of credit outstanding, currency mismatch, and the reduced inflow of foreign funds constitute the major risks for banking system development in the near future.

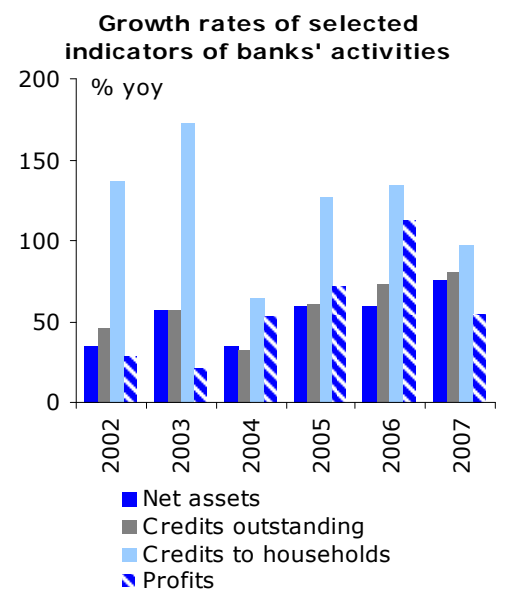
State debt. In January the Ministry of Finance carried additional placement of the five-year domestic state bonds maturing in 2010-2011 to improve the liquidity of the issue. The official purpose was to determine the market price of the state bonds at the beginning of the year and to construct the yield curve. Altogether the Ministry raised UAH 307.9 m. The issue of two-years-to-maturity bonds yielded 6.5% - 7.6% p.a., while three-year-to-maturity bonds were sold with 7.5% yield. Thus, average yield of the bonds placed in January was 7.1% p.a. that is 0.8 percentage points higher as compared to the last issues in 2007. This placement was the first official attempt to investigate the investors expectations at the beginning of the year.



Source: State Budget Laws for 2002-2008



Source: Derzhcomstat, NBU



Source: NBU



Economic Trends		Q2 06	Q3 06	Q4 06	Q1 07	Q2 07	Q3 07	Sep	Oct	Nov	Dec	Jan
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	7.3	...
Industrial production (real)	% yoy cum.	3.6	5.5	6.2	12.5	11.8	10.7	10.7	11.0	10.7	10.2	...
Agricultural production (real)	% yoy cum.	3.2	-2.8	0.4	5.0	6.3	-5.1	-5.1	-5.7	-5.7	-5.6	...
CPI	% yoy eop	6.8	9.1	11.6	10.1	13.0	14.4	14.4	14.8	15.2	16.6	19.4
PPI	% yoy eop	6.3	10.7	14.4	17.9	20.6	19.6	19.6	19.7	20.0	23.3	23.3
Exports (USD)***	% yoy cum.	4.7	10.7	13.2	32.4	32.4	27.3	25.7"	27.4"	27.9"
Imports (USD)***	% yoy cum.	19.7	19.8	22.0	32.0	33.2	31.5	31.2"	32.9"	34.2"
Merchandise trade balance	USD bn cum.	-2.16	-2.93	-5.19	-1.75	-3.18	-5.38	-3.71"	-8.22"	9.59"
Current account	USD bn cum.	-0.78	-0.32	-1.62	-1.31	-2.00	-2.15	x	x	x	x	x
Current account	% GDP, cum.	-1.8	-0.4	-1.5	-5.0	-3.4	-2.2	x	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	31.8
Monetary Base	% yoy eop	22.4	20.3	17.5	27.7	38.4	50.6	50.6	48.5	48.4	46.0	42.7
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	13.9
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	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	7.36	7.42

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