

Monthly Economic Monitor Ukraine

No.5 (91)
May
2008

- Coalition becomes increasingly divided.
- Real GDP growth reached 6.0% yoy in the first quarter of 2008.
- The Government increased grain export quotas and extended them to June.
- In May Ukraine will become the newest WTO member after the Verkhovna Rada ratified the final agreement last month.
- The central budget turned into deficit in the first quarter as the execution of expenditures improved.
- The Government delayed introduction of targeted social assistance.
- Consumer inflation reached 30.2% yoy in April as meat and vegetable prices jumped.
- Hryvnia steadily appreciated against US dollar despite the NBU interventions.

Population: 46.4 m
Industry/GDP: 32%
Agriculture/GDP: 7%
Investment/GDP: 27%
Exports to: Russia 26%, EU 28%
Imports from: Russia 28%, EU 37%

Politics: Tensions between the President and Prime-Minister grow

In April divisions inside the ruling coalition widened. Legal tensions between the President and the Prime Minister over questions of privatization and land sales continued with blatant disregard to the law by all involved political forces. The latest moves included presidential decrees suspending allegedly anti-constitutional government decisions and countermoves by the government through re-issuance of suspended resolutions or hasty court decisions. Further on presidential decrees on the same subject were met with orders by the Prime Minister to ignore them but this time without backing of new court decisions or government resolutions. Disregard of the law by the top officials of the executive branch dealt another blow to attempts to develop rule of law in the country.

On the other field of controversy, Prime-Minister Yulia Tymoshenko and BYT parliamentary faction discussed establishing a constitutional commission with the opposition Party of Regions faction with a view to transform Ukraine into a parliamentary republic. President Viktor Yushchenko naturally opposes such changes emphasizing immaturity of Ukrainian democracy. This commission, if created, will also render the Constitutional Council created by the President useless. Also the Constitutional Court recently ruled that Constitution couldn't be amended on referendum without additional laws passed. Hence the President won't be able to offer his version of constitutional amendments to the people directly. Representatives of Our Ukraine-Self Defence block, another member of the coalition, were split on the issue adding new tensions to the already fragile coalition.

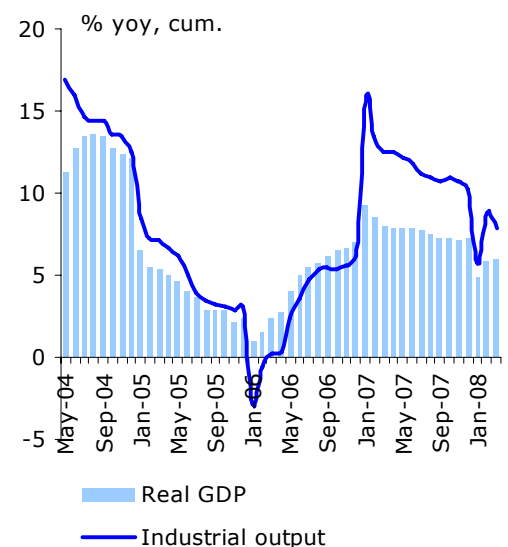
Real economy: Real GDP grew by 6.0% yoy in the first quarter

In the first quarter of 2008, real GDP grew by 6.0% yoy compared to 8.0% yoy a year ago. As before, trade, manufacturing and transport were main engines of growth, explaining approximately three quarters of the change in economic activity level. Recovery in the construction sector continued in March, almost compensating the January drop, while agricultural production remained fairly constant, growing merely 0.4% yoy. According to Derzhkomstat, between January and March industrial output increased by 7.8% yoy. Food industry, metal production and machine building remained the largest contributors to the industrial expansion. Large reductions in coke production and petroleum refinement were compensated by imports.

Sectoral trends: Grain export quotas were increased

Agriculture. Expectations of market participants that the Government will cancel export quotas on wheat and barley given large stocks and expected good harvest turned out to be

Real growth rates of GDP and industrial production



Source: Derzhkomstat

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overoptimistic. The Government increased export quotas for barley and wheat, but extended them to the end of June. Export quota for wheat is increased from 0.2 m tonnes to 1.2 m tonnes. Export quota for barley is increased from 0.4 m tonnes to 0.9 m tonnes. Also, sunflower oil quotas instituted on March 22 were finally distributed on April 16 ending three-week suspension of exports.

The Government also intervened on the meat market and signed a Memorandum with meat-processors, intending to limit a further increase in meat prices. However, retail prices continued to grow. Thus, the practice of signing memorandums with producers to contain price growth once again proved to be of little efficiency.

Energy. The National Electricity Regulatory Commission of Ukraine (NERC) issued a license to the newly created Gazprom's subsidiary "Gazpromsbyt Ukraine" to supply 7.5 bn cubic m of natural gas in 2008 to industrial consumers. The license of other gas trader, UkrGazEnergo, was cancelled enabling the state energy monopolist "Naftogaz of Ukraine" to return to this segment of the market. However, court order restored to UkrGazEnergo its license to sell 32 bn cubic meters of gas this year, increasing the uncertainty which company will sell imported gas on domestic market.

Privatisation. In April the State Property Fund (SPF) cancelled the privatization of the Odessa by-port plant in accordance with the Presidential decree motivated by the need to approve State Privatisation Program. The auction scheduled for May attracted considerable interest, with 20 bidders registering to participate and 8 bidders applying for competition review of the potential deal. The abolition of the tender made the financing of the budget deficit more difficult and created additional tensions between the President and the Prime Minister.

Transport. In April the Ministry of Transport and Communications postponed the scheduled increase in passenger railway ticket prices for domestic fares. The measure had been intended to cut losses resulting from passenger transportation. The decision was most likely motivated by the Government's desire not to facilitate inflation this year, although it definitely adds to future inflationary pressures and endures cross-subsidisation between freight and passenger railway transport services.

External sector: Ukraine will become the newest WTO member in May as final agreement ratified

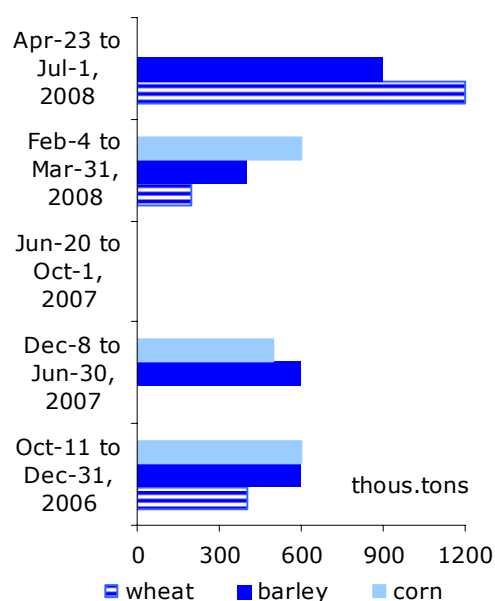
In April the Verkhovna Rada ratified the agreement on Ukraine's WTO membership. Thus, in May Ukraine will become the 152th member of the WTO. The accession envisages the reduction and binding of import tariffs, gradual reduction of export tariffs, the elimination of quantitative export restrictions and the liberalization of trade in services. It is estimated that the WTO membership will be beneficial for the country, adding extra 2.5% to real GDP and 7.2% to welfare over the medium-term.

According to the Derzhkomstat, in the first two months of the year the commodity exports increased by 26.2% yoy in US dollar terms, while imports excluding natural gas surged by 47.1% yoy. One of the reasons for strong growth of external trade is the increasing world prices for wide range of goods including food, energy, chemicals, and metals. Another reason for spectacular rise in imports is strong internal demand for investment as well as consumption goods.

Fiscal policy: The central fiscal deficit reached UAH 2.3 bn or 1.2% of GDP

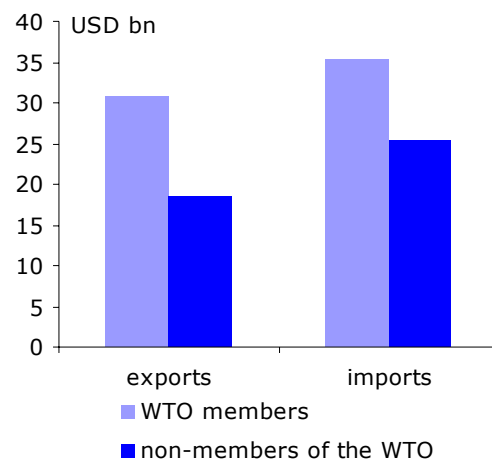
In the first quarter of 2008 the central fiscal revenues were executed at 108.6% of the target due to high tax revenues. In particular, the VAT and enterprise profit tax revenues were over-executed by 5.8% and 22.7%, respectively. Moreover, additional receipts from VAT on import received due to the prohibition of tax bills circulation and resumption of anti-smuggling activity allowed the Government to

Export quotas for wheat, barley and corn in 2006-2008



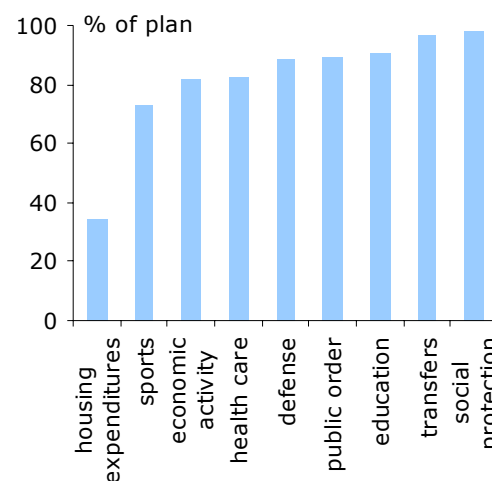
Source: Cabinet of Ministers' Decrees

Ukraine's commodity trade in 2007



Source: Derzhkomstat, IER estimate

Central fiscal expenditures in the first quarter of 2008



Source: State Treasury

improve the VAT reimbursement. At the same time, receipts from excise duties and official transfers were under-executed.

The execution of central fiscal expenditures improved to 92.5% of the planned level, though remaining lower than targeted. Traditionally, social protection expenditures and transfers to local budgets had the highest execution rate at above 95% of the target, while housing expenditures were financed only at 34.7% of the plan. As a result central fiscal balance turned negative and reached UAH 2.3 bn or 1.2% of GDP.

Social policy: Privileges continue to be provided regardless of income

In April the Cabinet of Ministers approved a Resolution envisaging the provision of the privileges to certain groups of individuals, including labour veterans, retired judges and prosecutors, disabled persons etc. regardless of income. This Resolution *de facto* overrides the provisions of the State Budget Law for 2008, according to which starting May 1 only individuals with incomes lower than 1.4 times the subsistence minimum are eligible for privileges. Therefore, the Government once again delayed the introduction of the targeted social assistance. Moreover, the decision increases the fiscal pressure as it widens social obligations for the current fiscal year.

The Pension Fund reported own revenues of UAH 21.9 bn in the first quarter with 41.8% yoy increase. Revenues grew in line with wages. The Pension Fund also received the transfer from central budget amounting to UAH 7.8 bn or 26.2% of annual plan. At the same time, Pension Fund spent UAH 33.4 bn. The deficit at UAH 3.7 bn was most likely financed through the special loans from Treasury.

Monetary policy: Inflation crossed 30% mark

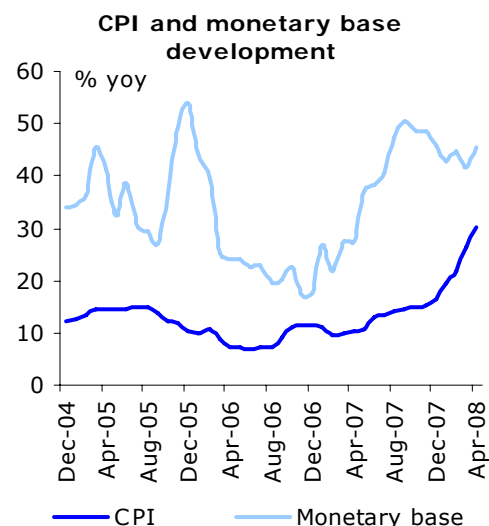
In April inflation reached 30.2% yoy while monthly increases in consumer prices remained over 2% for eight months in row. Jumps in meat and vegetable prices caused by seasonal factors and anti-smuggling campaign explain most of acceleration of inflation. Other components of consumer basket displayed relatively mild dynamics despite another round of increases in social payments in April. This might be attributed to lower demand due to increased sensitivity of households to higher prices. Slower inflation in summer is quite probable as good harvest becomes increasingly likely.

Monetary base increased by 45.6% yoy and money supply by 52.4% yoy in April. Liquidity remained limited supporting inter-bank lending rates at high levels for the third month in a row. As liquidity exhibited high volatility, interbank rates ranged from 9% to as high as 35%. Sustained high interest rates slowed expansion in credit provided to enterprises: net loans issued to enterprises in April decreased to UAH 5.9 bn as compared to UAH 16.7 bn in March.

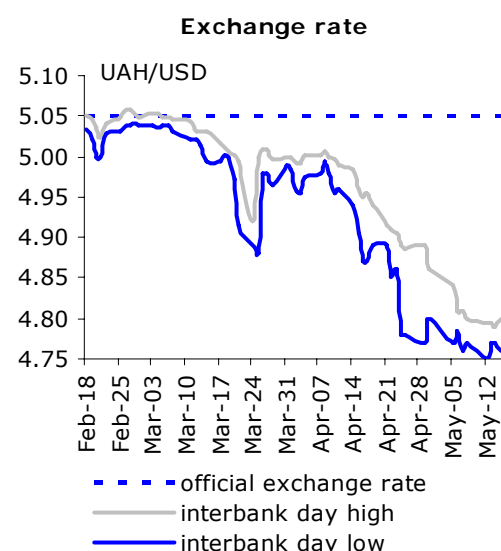
Financial markets: Hryvnia continued to appreciate against the US dollar

Exchange rate. Hryvnia continued to appreciate against US dollar in April despite NBU interventions totalling USD 619 m. Lack of hryvnia liquidity, continued capital inflows and seasonal increase in cash supply seem to be the main reasons for continued appreciation of hryvnia. Over the month hryvnia gradually appreciated from 4.98-5.00 UAH per USD to 4.78-4.80 UAH per USD range. Despite clear signs of more flexibility, the new exchange rate regime remains unclear as NBU didn't indicate a new exchange rate band and the official NBU rate remains unchanged at 5.05 UAH per USD.

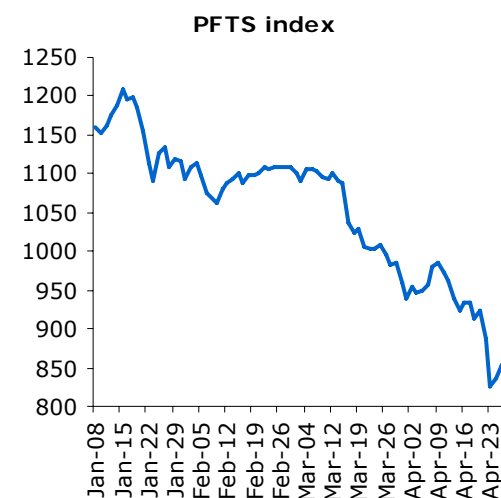
Stock market. The Ukrainian stock market continued to shrink. The main Ukrainian stock market index PFTS dropped by 12.1% in April, while the cumulative decline was 38.7% since the beginning of the year. As foreign stock markets demonstrated stability in April, the fall in Ukraine is mostly attributed to internal factors, such as oversupply of stocks, in particular by banks, as well as lack of liquidity at Ukrainian financial markets. However, sell-off of stocks ahead of May holidays was caused by expectations of recession in the US.



Source: Derzhkomstat, NBU



Source: Reuters Investor



Source: PFTS



Economic Trends		Q4 06	Q1 07	Q2 07	Q3 07	Q4 07	Q1 08	Jan	Feb	Mar	Apr
GDP growth (real)	% yoy	9.5	8.9	8.6	6.2	7.4	...	4.9	6.7	6.5	6.2
GDP growth (real)	% yoy cum.	7.1	8.0	7.9	7.3	7.6	...	4.9	5.8	6.0	6.7
Industrial production (real)	% yoy cum.	6.2	12.5	11.8	10.7	10.2	7.8	5.7	8.8	7.8	8.0
Agricultural production (real)	% yoy cum.	0.4	5.0	6.3	-5.1	-5.6	0.2	0.0	0.7	0.2	0.4
CPI	% yoy eop	11.6	10.1	13	14.4	16.6	26.2	19.4	21.4	26.2	30.2
PPI	% yoy eop	14.4	17.9	20.6	19.6	23.3	31.8	23.3	25.6	31.8	37.5
Exports (USD)***	% yoy cum.	13.2	32.4	32.4	27.3	27.4	...	14.0"	26.2"
Imports (USD)***	% yoy cum.	22.0	32.0	33.2	31.5	34.8	...	27.9`	47.1`
Merchandise trade balance	USD bn cum.	-5.19	-1.74	-3.43	-6.12	-10.6
Current account	USD bn cum.	-1.62	1.21	-1.98	-2.47	-5.92	...	x	x	x	x
Current account	% GDP, cum.	-1.5	-4.6	-3.4	-2.5	-4.2	...	x	x	x	x
Gross international reserves	USD bn eop	22.3	22.9	25.9	30.6	32.5	33.2	31.8	32.5	33.2	33.3
Monetary Base	% yoy eop	17.5	27.7	38.4	50.6	46.0	41.4	42.7	44.9	41.4	45.6
Lending rate on UAH credits **	% pa, aop	15.1	14.0	13.9	13.7	14.0	14.6	13.9	14.6	15.2	16.9
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
Exchange rate (official)	EUR aop	6.51	6.62	6.81	6.93	7.31	7.56	7.42	7.43	7.81	7.96

SOURCES: Derzhkomstat, Ministry of Finance, NBU, IFS, own calculations

" Monthly figures are only for merchandise exports and imports (source: Derzhkomstat)

` January and February imports figures exclude gas due to pricing dispute

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		1999	2000	2001	2002	2003	2004	2005	2006	2007
Nominal GDP	UAH bn	130.4	170.1	204.2	225.8	267.3	345.1	441.5	544.2	712.9
Nominal GDP	USD bn	31.6	31.3	38.0	42.4	50.1	65.0	86.2	107.8	141.2
GDP growth (real)	% yoy	-0.2	5.9	9.2	5.2	9.6	12.1	2.7	7.3	7.6
Industrial production	% yoy	4.0	13.2	14.2	7.0	15.8	12.5	3.1	6.2	10.2
Agricultural production	% yoy	-6.9	9.8	10.2	1.2	-11.0	19.7	-0.1	0.4	-5.2
CPI	% yoy aop	22.7	28.2	12.0	0.8	5.2	9.0	13.5	9.1	16.6
CPI	% yoy eop	19.2	25.8	6.1	-0.6	8.2	12.3	10.3	11.6	12.8
PPI	% yoy aop	31.5	20.9	8.6	3.1	7.6	20.5	16.7	9.6	19.5
PPI	% yoy eop	15.7	20.8	0.9	5.7	11.1	24.1	9.5	14.1	23.3
Exports (gs, USD)	% yoy	-7.9	17.9	9.5	10.7	24.0	42.6	7.5	13.2	27.4
Imports (gs, USD)	% yoy	-19.1	18.9	14.1	4.9	28.7	31.3	20.4	22.0	34.8
Current account	USD bn	0.9 °	1.2 °°	1.4	3.1	2.9	6.9	2.5	-1.6	-5.9
Current account	% GDP	2.9 °	3.8 °°	3.7	7.6	5.9	10.6	2.9	-1.5	-4.2
FDI (net)	USD bn	0.5	0.6	0.8	0.7	1.4	1.7	6.5	5.3	9.2
International reserves	USD bn	1.09	1.48	3.09	4.42	6.94	9.52	19.39	22.26	32.48
Fiscal balance'''	% GDP	-2.1	-0.7	-1.9	0.8	-0.2	-3.0	-1.9	-0.9	-1.1
Total state debt	% GDP eop	61.0	45.3	36.5	33.5	29.0	24.7	17.7	15.0	12.6
External state debt (total)	% GDP eop	49.9	33.0	26.3	24.1	21.4	18.6	13.4	11.7	10.1
Monetary base	% yoy eop	39.3	39.9	37.4	33.6	30.1	34.1	53.9	17.5	46.0
Exchange rate	USD aop	4.13	5.44	5.37	5.33	5.33	5.31	5.12	5.05	5.05
Exchange rate	USD eop	5.07	5.44	5.30	5.33	5.33	5.31	5.05	5.05	5.05
Exchange rate	EUR aop	4.39	5.03	4.81	5.03	6.02	6.62	6.40	6.32	6.92
Exchange rate	EUR eop	5.20	5.10	4.67	5.53	6.66	7.22	5.97	6.65	7.42

SOURCES: Derzhkomstat, NBU, 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