

# Monthly Economic Monitor Ukraine

**No.6 (92)  
June  
2008**

- Tensions between the President and the Prime Minister continued to grow.
- Between January and April real GDP increased by 6.2% yoy backed by strong private consumption, while investments slowed.
- Gas prices for industrial consumers are going up.
- The Government cancelled grain export quotas.
- In the first quarter merchandise trade deficit reached USD 5.0 bn.
- In April the central fiscal deficit reached 1.0% of GDP as expenditures execution continued to improve.
- The Constitutional Court ruled to restore social benefits.
- Consumer price inflation accelerated to 31.1% yoy in May.
- The NBU revised hryvnia official exchange rate against US dollar upwards by 4%.

**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 continue to grow

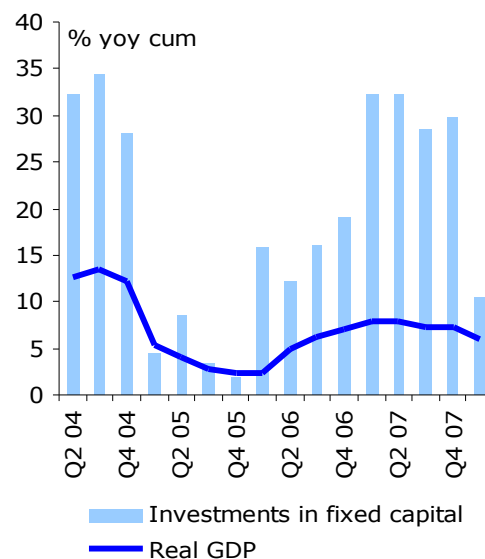
In May the political situation in Ukraine was marked by further aggravation of political confrontation between the President and the Prime Minister. The opponents continued to accuse each other of undermining the unity of the democratic coalition. Prime Minister Yulia Tymoshenko blamed President Viktor Yushchenko for putting constant obstacles to the government’s activities and hampering it in fulfilling its social obligations. Also, she severely criticized the Constitutional Court for making a “politically biased ruling” over the 2008 budget, which allegedly deprived the Government of financial resources for welfare payments. In its May 27 ruling, the Constitutional Court decided that the budget law should include only budgetary provisions, while changes to tax and social protection legislation should be made separately. According to the Prime Minister, this ruling was made under joint pressure from the President and the opposition. At the same time, the President criticized the Government for not fighting inflation effectively, state property mismanagement and political manoeuvring in anticipation of presidential elections.

## Real economy: Real GDP grew by 6.2% yoy in the first four months

According to the Derzhkomstat, in the first four months of the year real GDP increased by 6.2% yoy as growth in manufacturing and trade accelerated slightly. In particular, manufacturing output grew by 8.7% yoy explaining the most of the 8.0% yoy rise of industrial output. At the same time, the recovery of construction halted in April as the sector value added contracted by 2.7% yoy on a cumulative basis. The growth of agriculture value added remained close to zero.

On the demand side economic growth was based on consumer demand as shown by continued retail sales boom, while investments have considerably decelerated. According to the Derzhkomstat, between January and March investments in fixed assets increased by 10.4% yoy compared to 32.2% yoy growth a year ago. This slowdown is largely attributed to lower manufacturing investments that account for more than a quarter of total investments and the growth rates of which reduced to 2.0% yoy in the first quarter of 2008 from 54.8% yoy a year ago. The deceleration of investment could be explained by sustained political uncertainty, mounting inflationary pressures, and more costly financing both on domestic and external markets. As these factors are expected to remain in effect over 2008, the investment growth may moderate this year.

**Real GDP and investments growth**



Source: Derzhkomstat

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### Sectoral trends: Gas prices are set to increase

**Energy.** The Ministry of Fuel and Energy allowed the NJSC "Naftogaz Ukrainy" to increase costs of natural gas sales passed on customers to UAH 105 per thousand cubic meters (tcm) since May. Also, the special tax on gas sales was revised three times for industrial consumers since the beginning of the year. The tax escalated from 0.01% in January to 6% in June for chemical industry, and from 2% to 12% respectively for other industrial consumers. As a result, starting in June, the price of natural gas for chemical industry consumers and other industrial consumers rose to UAH 1386.98 per tcm and UAH 1431.85 per tcm respectively reaching almost USD 300 per tcm. So far the gas price for households that consume domestic gas have remained unchanged and much lower than for industrial consumers. But it is expected that prices for population will grow by 3-5% monthly during the second half of 2008 to reduce the gap and to stimulate domestic gas production.

**Agriculture.** The Government cancelled the export quotas for wheat, barley, corn and rye since May 23. The Prime Minister explained the decision mainly by good prospects for the 2008 grain crop that is expected at 39-40 m tonnes compared to 29.3 m tonnes in 2007. At the same time, on April the Cabinet of Ministers extended sunflower oil and seeds export quotas until September creating additional pressure on the sector, where the restrictions have already resulted in temporary closure of 15 oil extraction plants. The situation has been further complicated by the recent case of spoiled sunflower oil exports to the EU, prompting additional inspections. Thus, sunflower oil export was almost stopped. Though, on May 28 the President suspended sunflower oil export restrictions pending their review by the Constitutional Court. This decision may open the way for restoring exports.

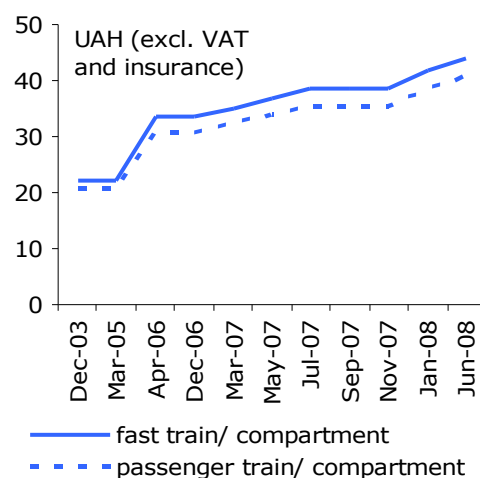
**Privatisation.** May was marked by the increased uncertainty over the State Property Fund (SPF) management and privatization process itself. The Prime Minister suspended Valentyna Semenyuk as the Head of the SPF and appointed Andriy Portnov as the Acting Head. The President abolished the decision claiming that the appointment of temporary management for SPF was out of bounds of the Government authority. Mrs. Semenyuk continued working. She abolished the sale shares in six oblenergos as well as the Odessa by-port plant auction. In the middle of May the Cabinet of Ministers transferred the management of the state stakes in the largest objects envisaged for this year's privatisation from the SPF to itself, trying to limit the SPF influence on the privatisation. The President suspended this decision too.

**Transport.** In May tariffs for transportation services, in particular for airports and railways, continued to grow. The Transport and Communications Ministry increased prices for airport services in the range of 50-250%. In addition, it decided to raise domestic railways passenger transportation tariffs by 5% in June. The measures showed preference to cutting losses from passenger transportation over the attempts to limit inflation pressure through low regulated prices. Expected reorientation of passenger flows to road transport can cause further roads deterioration and negative environmental impacts.

### External sector: Merchandise trade deficit expanded to USD 5.0 bn

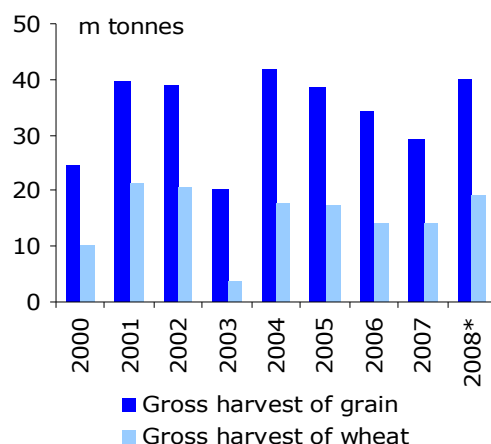
Merchandise trade deficit continued to expand in the first quarter of 2008 and according to the Derzhkomstat reached USD 5.0 bn. High deficit is explained by rapid expansion of imports thanks to strong domestic demand and gradual revaluation of hryvnia. Between January and March exports of goods grew by 28.5% yoy in dollar terms, while the growth of imports was 45.1% yoy. In particular, consumer goods imports including food products, textile, and shoes significantly increased as compared to the previous year due to growing world prices, further expansion of internal demand, as well as intensified fight against smuggling. On the other hand, sharp decrease in volume of imported gas somewhat constrained imports

Passenger railway transportation tariffs (distance = 500 km)



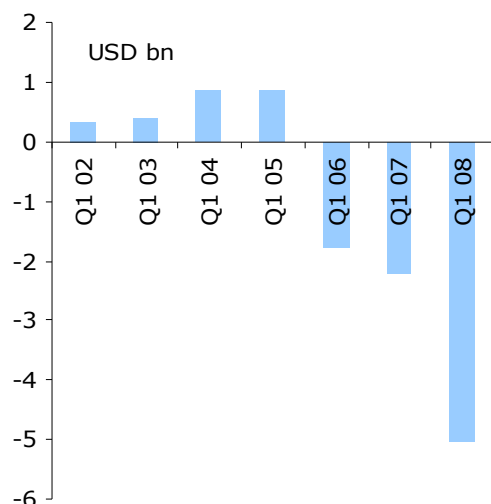
Source: Ministry of Transport and Communications

Grain harvest in Ukraine



Source: Derzhkomstat  
Note: \* Forecast

Merchandise trade balance



Source: Derzhkomstat

growth. The reduction of import tariffs on agricultural and foods products due to the WTO membership of Ukraine is expected to further stimulate imports in the second half of this year.

**Fiscal policy: Central fiscal deficit reached 1.0% of GDP**

Between January and April central fiscal revenues were 11.5% above target level due to higher than planned tax revenues. In particular, revenues from the enterprise profit tax (EPT) were over-executed by 30% backed by surge of prices in the first quarter. The execution rate of the VAT revenues from imports was 37% higher than projected, while the collection of VAT levied on domestic goods was 6% below the target. The execution of central fiscal expenditures was 93.5% of the target, with social protection expenditures and transfers to local budgets both executed at 98% of the plan, while the utilities sector was traditionally deeply underfinanced. The central fiscal deficit amounted to UAH 2.6 bn or 1.0% of the GDP.

**Social policy: Constitutional Court ruled to restore social benefits**

In May the Constitutional Court of Ukraine (CCU) published its decision on the unconstitutionality of several provisions of the State Budget Law for 2008. Among other things, it revoked the provisions that terminated privileges to judges and court officials, public sector employees and military men, as well as war veterans and pensioners. However, the CCU decision probably will not be implemented due to absence of sufficient financing. For instance, in 2007 the required funds were estimated at UAH 70 bn. The Court's decision once again drew attention to the necessity of social welfare system reform as the system is over-burdened by various privileges.

**Monetary policy: Inflation continued to accelerate**

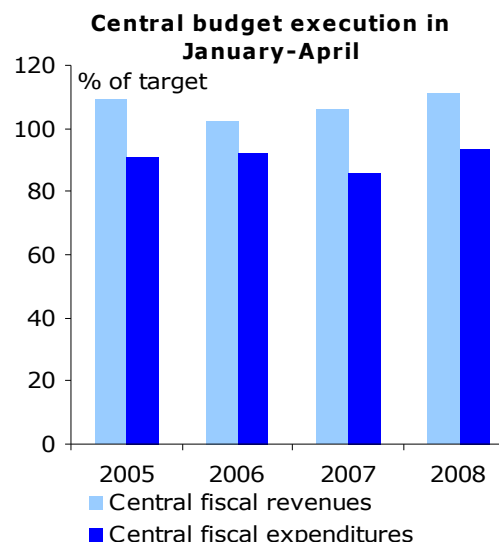
In May consumer inflation accelerated to 31.1% yoy marking fifteen months of increasing inflation and further fuelling inflationary expectations. However, monthly price increases decelerated for the third month in the row as consumer demand cooled and no external shocks were observed.

Monetary base increased by 38.8% yoy and money supply by 48.8% yoy in April. Liquidity remained tight as the Ministry of Finance hoarded government funds at the NBU, and large social payments caused outflows of cash from banking system. However, volatility on the interbank market reduced slightly, and interest rates remained in 15-25% range in the second half of the month. High interbank interest rates have already translated into higher interest rates for loans and deposits and limited credit.

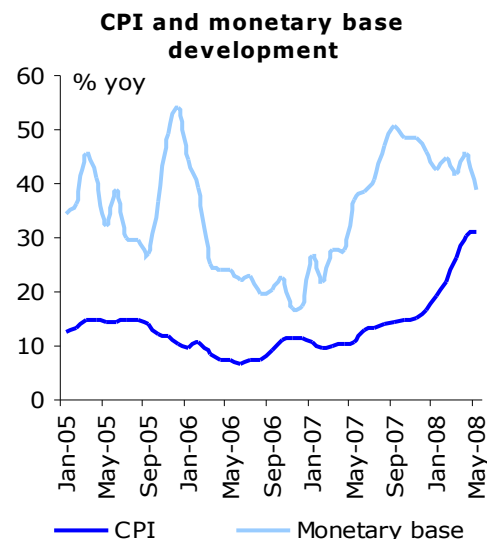
**Financial markets: The NBU revised hryvnia official rate upwards to UAH 4.85 per USD**

**Exchange rate.** Hryvnia continued to appreciate against US dollar in May. On May 21 the hryvnia reached intraday low of UAH 4.52 per USD. Up to this day, the NBU stayed out of currency market but maintained the indicative official rate of 5.05 UAH per USD. On May 22 the NBU revised hryvnia official rate upwards to UAH 4.85 per USD and intervened at interbank market buying US dollars for UAH 4.8 per USD. While the official rate is indicative and used for accounting and customs applications only, this decision sparked public debate on exchange rate appreciation and created political pressure on the NBU. By the end of the month, the inter-bank exchange rate stabilised and moved in UAH 4.70-4.80 per USD range.

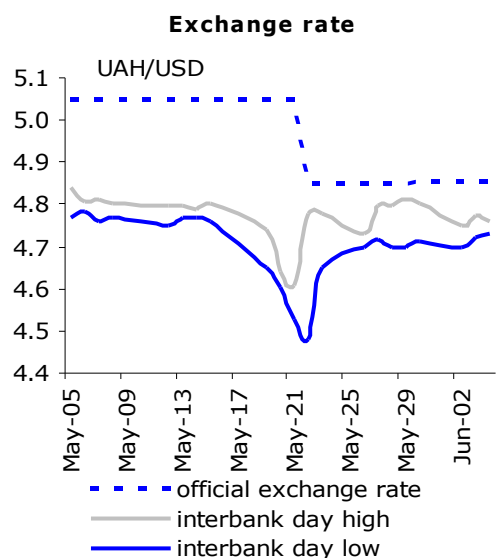
**Credit unions.** In May the State Financial Services Commission revised supervision standards for credit unions. According to the new rules, credit unions can be declared bankrupt if their losses constitute more than 25% of their reserves, initial deposits and special contributions to capital. Besides, credit unions will be liquidated if they do not meet more than 10% of their obligations within 30 days after the due date. These changes should help to remove insolvent credit unions from the market.



Source: State Treasury reports



Source: Derzhkomstat, NBU



Source: Reuters Investor



<b>Economic Trends</b>		<b>Q4 06</b>	<b>Q1 07</b>	<b>Q2 07</b>	<b>Q3 07</b>	<b>Q4 07</b>	<b>Q1 08</b>	<b>Feb</b>	<b>Mar</b>	<b>Apr</b>	<b>May</b>
GDP growth (real)	% yoy	9.5	8.9	8.6	6.2	7.4	...	6.7	6.5	6.7	...
GDP growth (real)	% yoy cum.	7.1	8.0	7.9	7.3	7.6	...	5.8	6.0	6.2	...
Industrial production (real)	% yoy cum.	6.2	12.5	11.8	10.7	10.2	7.8	8.8	7.8	8.0	...
Agricultural production (real)	% yoy cum.	0.4	5.0	6.3	-5.1	-5.6	0.2	0.7	0.2	0.4	...
CPI	% yoy eop	11.6	10.1	13	14.4	16.6	26.2	21.4	26.2	30.2	31.1
PPI	% yoy eop	14.4	17.9	20.6	19.6	23.3	31.8	25.6	31.8	37.6	39.4
Exports (USD)***	% yoy cum.	13.2	32.4	32.4	27.3	27.4	...	26.2"	28.5"	...	...
Imports (USD)***	% yoy cum.	22.0	32.0	33.2	31.5	34.8	...	...	45.2"	...	...
Merchandise trade balance	USD bn cum.	-5.19	-1.74	-3.43	-6.12	-10.6	...	...	-5.0"	...	...
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	32.5	33.2	33.3	34.4
Monetary Base	% yoy eop	17.5	27.7	38.4	50.6	46.0	41.4	44.9	41.4	45.6	38.8
Lending rate on UAH credits **	% pa, aop	15.1	14.0	13.9	13.7	14.0	14.6	14.6	15.2	16.9	17.5
Exchange rate (official)	USD aop	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	4.99
Exchange rate (official)	EUR aop	6.51	6.62	6.81	6.93	7.31	7.56	7.43	7.81	7.96	7.76

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

<b>Key Economic Indicators</b>		<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2007</b>
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:

<b>avg</b>	average	<b>ytd</b>	year-to-date
<b>cum</b>	cumulative	<b>p.a.</b>	per annum
<b>mom</b>	month on month change	<b>eop</b>	end of the period
<b>qoq</b>	quarter on quarter change	<b>aop</b>	average of the period
<b>yoy</b>	year-on-year change	<b>gs</b>	goods and services