



Monthly Economic Monitor Ukraine

- Three more 'orange' ministers were dismissed by the Parliament.
- Real economic growth accelerates to 6.5% yoy in the first ten months of the year.
- Government resorts to administrative measures to contain prices.
- In November and early December the Parliament passed 15 of 20 remaining laws needed for the completion of WTO accession process.
- The central fiscal revenues and expenditures for 2006 were revised upwards by UAH 1.7 bn thanks to higher VAT revenues.
- In November inflation moved up to 11.6% yoy.
- Branches of foreign banks will be allowed in Ukraine following its WTO accession.

**No.12 (74)
December
2006**

Population: 47 m
Industry/GDP: 27%
Agriculture/GDP: 10%
Investment/GDP: 19%
Exports to: Russia 18%, EU 29%
Imports from: Russia 40%, EU 32%

Politics: The President is increasingly at the losing end of the power struggle with the Prime Minister

November was marked by the continuation of the division of power process between the President and the Prime Minister. One of the sources of confrontation was the reluctance of Viktor Yanukovich, the Prime Minister, to submit directives for his visit to the USA for the President's approval. Only after the Minister of Foreign Affairs on the request of the President informed the US ambassador about possible rescheduling of the visit, the directives were submitted.

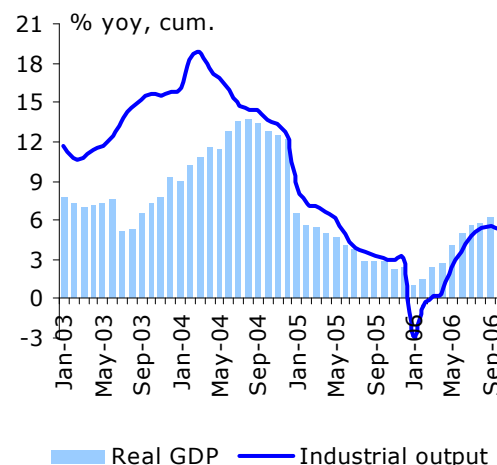
In addition, the process of the replacement of the 'orange' ministers in the Cabinet was continued. On November 28, the Parliament accepted resignation of Yuriy Pavlenko, the Family, Youth and Sports Minister, who was then replaced by the representative of the Party of Regions, Mr. Korzh. On December 1, the Verkhovna Rada fired the Interior Minister Yuriy Lutsenko, who was replaced by the leader of the Socialist faction Vasyl Tsushko, and the Foreign Minister Borys Tarasyuk. The only 'orange' minister remaining in the Cabinet is the Defense Minister Anatoliy Hrytsenko. The President nominated him and the Foreign Affairs Minister for the Cabinet position according to the Constitution. It is unclear whether the Parliament has a right to dismiss these Ministers without President's approval. Also, the 'Our Ukraine' faction states that the Verkhovna Rada broke rules of procedure while dismissing Mr. Lutsenko and Mr. Tarasyuk, and, thus, the dismissal was not legal.

Real sector: Real economic growth accelerated to 6.5% yoy in the first ten months of the year

According to the Derzhkomstat, in the first ten months of the year the real GDP increased by 6.5% yoy compared to 2.8% yoy growth a year before. The continued speeding of the economic growth is linked to the improved agricultural performance and stable development of services. The cumulative reduction of ten-month value added in agriculture was mere 0.7% yoy compared to 2.3% yoy drop in the previous period, thanks to good harvest of non-wheat grain, sugar beet, and rape seeds. Also, the construction continues speeding up against the background of previous-year reduction. At the same time, the industrial production growth slowed, likely due to reduction of world demand on Ukrainian products, in particular metals.

In the first nine months of the year investments in fixed capital increased by 16.1% yoy against 0.3% rise a year ago. According to the Derzhkomstat, the most of investments are directed to industry (38.4% of total amount), transport and telecommunications (18.7%) and real estate transactions, including residential construction (17.2%). The acceleration of investment activity should be attributed to a pressing need for investments in energy-saving technologies, as well as the booming domestic consumption that created ample opportunities for development of service sector and housing construction.

GDP and Industrial Output



Source: Derzhkomstat

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Sectoral trends: Government resorted to administrative measures to contain prices

Competition policy. In November, the Antimonopoly Committee of Ukraine (AMC) on the request of the Prime Minister investigated reasons for not reducing prices on transport services and food products in line with decrease in fuel costs. After the investigation, the AMC issued number of recommendations to individual producers, traders, transport carriers, and local governments to revise prices according to the fuel cost decrease. The reaction was mostly symbolic decreases or postponed increases in prices for some of the products under investigation. These measures indicate that the government is inclined to administratively regulated prices, the step that distorts market functioning and worsens investment climate.

Privatization. The draft of the Privatization Program for 2007-2009 submitted to the Verkhovna Rada by the State Property Fund, if approved, may considerably improve the privatization process in Ukraine. Today, the privatization is conducted in accordance with the Privatization Program for 2000-2002. The new program, setting objectives and principles of the privatization for next several years, will lead to higher transparency and predictability of the privatisation.

External sector: Parliament passed 15 of 20 laws necessary for WTO accession

In November and early December, Ukraine has made a significant step towards the completion of membership negotiations with the WTO. The Parliament passed 15 out of 20 laws required for the complete harmonization of Ukrainian legislation with the WTO rules. In particular, there were approved laws on non-discriminatory regulation regime in selected services, improved protection of intellectual property rights, adopted changes in several agricultural laws. In addition, five laws were passed in the first reading. However, Ukraine still did not reach a deal with Kyrgyzstan and not agree the aggregate measure of support in agriculture. Thus, the likelihood that negotiation will be concluded and the Final Report of the Working Party passed in 2006 seems low. This means that completing of talks may be postponed until the beginning of 2007.

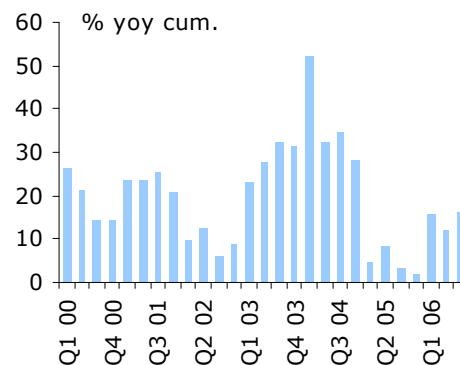
According to the Derzhkomstat, in the first nine months of the year commodity exports increased by 10.4% yoy in dollar terms, while the growth of imports was 22.2% yoy. Despite the significant acceleration of exports, continuation of higher import growth rates led to sustained commodity trade deficit at USD 4.06 bn.

Fiscal policy: Budget 2006 amendments were approved

In November the Parliament approved amendments to State Budget for 2006. The central fiscal revenues and expenditures were increased by 13.7% and 12.2% respectively. In nominal terms, the increase was symmetric at UAH 1.7 bn, not affecting the overall planned deficit at UAH 13.3 bn. The additional revenues will come from higher than planned VAT revenues. They will finance increase in social payments, transfers to the local budgets, privileges for utility services, and pension payments for military servants.

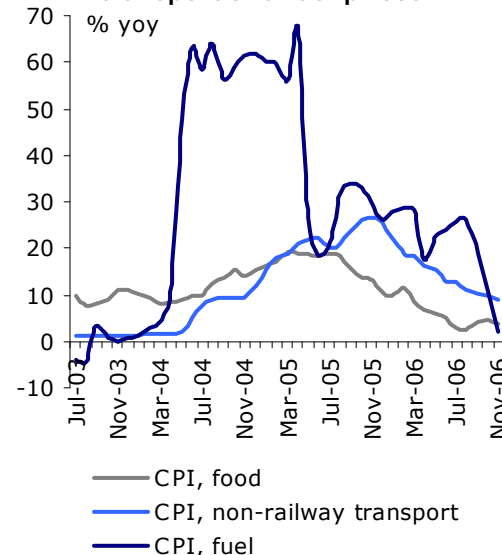
On December 1, the government finally submitted the revised Draft of the State Budget Law for 2007, though it was required to do so by November 20. The delay was explained by the late approval of the Law on tax amendments and the list of enterprises to be privatized in 2007. The Law on tax amendments was passed only on November 30 with the suggestions of the President, who has previously vetoed it. The Law summarizes the tax changes included in the first draft of State Budget Law for 2007. Among other changes, it foresees raising excise taxes for some products, additional restrictions on loss carry-forward and depreciation deduction, and increases in rent payments for the extraction of natural resources, including oil and gas. On the request of the President, the provisions on the reintroduction of certain privileges to the special economic zones will be summarized in a separate law.

Investment in Fixed Capital



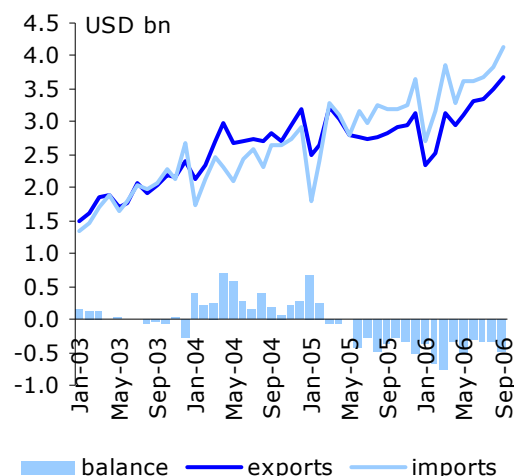
Source: Derzhkomstat

Development of food, transport and fuel prices



Source: Derzhkomstat

Merchandise Trade



Source: Derzhkomstat

Between January and October, the central fiscal revenues were executed at 102.2%. Good revenues performance is mainly explained by higher than planned receipts from VAT that were 17% (UAH 5.8 bn) above the target. Also, during the month the under-execution of revenues from enterprise profits tax (EPT) reduced from 15% to 11% of plan, although in nominal terms EPT revenues gap even slightly increased to UAH 1.9 bn. Following the pattern of the previous years, the execution of central fiscal expenditures improved as the end of year approaches and reached 95%. The resulting fiscal deficit reached UAH 5.1 bn or 1.3% of GDP.

Social policy: Consumption boom in 2006

Ukraine faces the consumption boom in 2006. In the first half of the year real final consumption of households increased by record 20% yoy, explained mainly by strong increase in household income and consumption credits. In the first nine months real households incomes grew by 20.1% yoy. This growth was backed by equivalent rise in real wage as well as sharp increase in the agricultural and entrepreneurial incomes of households. The growth rate of social transfers declined as compared to 2005 and amounted to 10.4% yoy. As a result, in 2006, contrary to 2005, wage income exceeded social transfers, becoming the primary source of households' income. Another reason for sharp increase in consumption was growth of credits to households, where net credits granted during the nine months of the year were 148% higher than in the same period of 2005. Such growth is partially explained by easier access of households to credits, and better access of banks to funding abroad.

Monetary policy: Inflation moved up to 11.6% yoy

Consumer inflation moved to 11.6% yoy in November from 11.0% in October. Increase in utility tariffs and fixed line tariffs was only partly offset by administrative measures aimed at price cuts, the reduction in natural gas tariffs for households effective from November 1, and moderate growth of monetary aggregates. Gradual lift of export restrictions on meat and dairy products to Russia on enterprise-by-enterprise basis, and policy concerning regulated prices will shape further inflation development in the country.

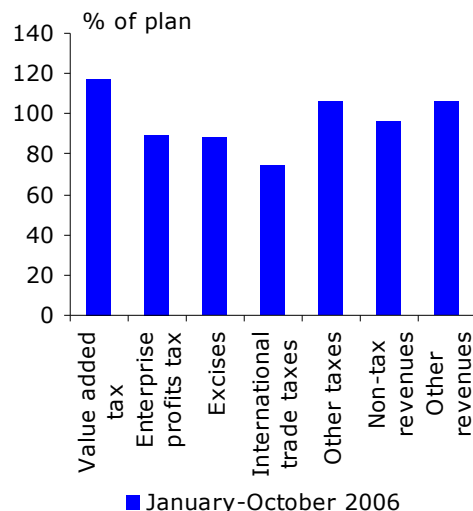
Broad money and monetary base grew 35.7% yoy and 17.2% yoy in November decelerating from 36.7% and 22.5% in October as NBU interventions decreased and government accumulated borrowed funds at treasury account. At the same time, international reserves of the NBU reached new historic record of USD 21.2 bn by the end of November as the NBU purchased USD 1 bn from the government acquired as proceeds from Eurobond issue.

Financial markets: Branches of foreign banks will be allowed following WTO accession

Banking sector. The Parliament approved a law, according to which foreign banks from countries that co-operate with FATF, adopted Basel principles of bank supervision, and signed agreement on bank supervision with the NBU will be allowed to open branches in Ukraine following Ukraine's WTO accession. The NBU will have significant leeway in allowing foreign bank branches to open in Ukraine as it can deny permission because of parent bank's financial or legal problems (terms vaguely defined in the law) or non-compliance with NBU regulatory documents. Therefore, degree of additional inflow of foreign capital in the banking sector will heavily depend on the regulatory decisions of the NBU. Still, the law will liberalize trade in financial services, contributing to improvement of pricing, quality and availability of these services in the country.

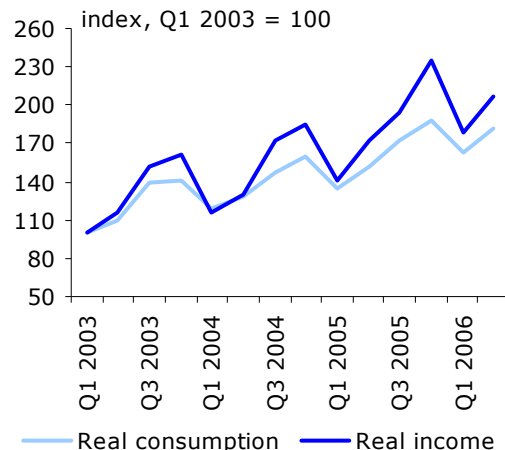
State debt. As privatization revenues have been too small to finance budget deficit, Ukraine turned to domestic and international debt market to finance this gap. On November 16, Ukraine finished placement of USD 1 bn issue of 10-year eurobonds with 6.58% coupon priced at quite modest 197 basic point spread over US treasuries. In November Ukraine also issued UAH 932 m worth of internal state debt bonds (OVDP).

Central fiscal revenues execution



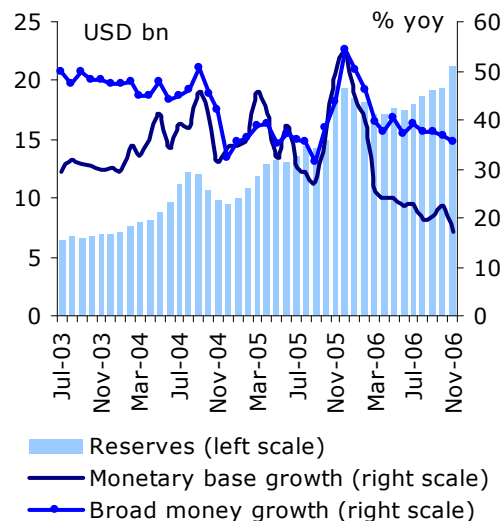
Source: The State Treasury reports

Households' real consumption and income



Source: Derzhkomstat

NBU foreign reserves and growth of monetary aggregates



Source: NBU



Economic Trends		Q4 05	Q1 06	Q2 06	Q3 06	Jun	Jul	Aug	Sep	Oct	Nov
GDP growth (real)	% yoy	1.7	3.2	7.3	...	9.3	7.7	7.1	8.9	9.0	...
GDP growth (real)	% yoy cum.	2.6	3.2	5.4	...	5.0*	5.5*	5.7*	6.2*	6.5*	...
Industrial production (real)	% yoy cum.	3.1	0.2	3.6	5.5	3.6	4.8	5.4	5.5	5.3	...
Agricultural production (real)	% yoy cum.	0.0	4.0	3.2	-2.8	3.2	-1.9	-2.8	-2.8	-1.1	...
CPI	% yoy eop	10.3	8.6	6.8	9.1	6.8	7.4	7.4	9.1	11.0	11.6
PPI	% yoy eop	9.6	6.5	6.3	10.7	6.3	9.4	10.9	10.7	13.1	14.0
Exports (USD)***	% yoy cum.	7.5	-0.3	4.7	...	2.1"	4.8"	7.9"	10.4"
Imports (USD)***	% yoy cum.	20.4	24.9	19.7	...	22.1"	21.3"	21.2"	22.2"
Merchandise trade balance	USD bn cum.	-1.14	-1.29	-2.16	-2.9 ^e	-2.92"	-3.26"	-3.59"	-4.06"
Current account	USD bn cum.	2.53	-0.74	-0.78	-0.2 ^e	x	x	x	x	x	x
Current account	% GDP, cum.	3.0	-3.7	-1.8	-0.3 ^e	x	x	x	x	x	x
Gross international reserves	USD bn eop	19.39	17.3	17.7	19.1	17.7	18.0	18.6	19.1	19.5	21.2
Monetary Base	% yoy eop	53.9	25.2	22.4	20.3	22.4	23.8	19.5	20.3	22.5	17.2
Lending rate on UAH credits **	% pa, aop	16.4	15.8	15.5	14.6	15.5	15.0	14.6	14.6	14.3	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	6.00	6.07	6.34	6.43	6.40	6.40	6.47	6.43	6.37	6.49

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

^e Preliminary estimate provided by the NBU

Key Economic Indicators		1998	1999	2000	2001	2002	2003	2004	2005
Nominal GDP	UAH bn	102.6	130.4	170.1	204.2	225.8	264.2	345.9	424.7
Nominal GDP	USD bn	41.9	31.6	31.2	37.8	42.6	49.5	65.1	83.1
GDP growth (real)	% yoy	-1.9	-0.2	5.9	9.2	5.2	9.4	12.1	2.6
Industrial production	% yoy	-1.0	4.0	13.2	14.2	7.0	15.8	12.5	3.1
Agricultural production	% yoy	-9.6	-6.9	9.8	10.2	1.2	-11.0	19.1	0.0
CPI	% yoy aop	10.6	22.7	28.2	12.0	0.8	5.2	9.0	13.5
CPI	% yoy eop	20.0	19.2	25.8	6.1	-0.6	8.2	12.3	10.3
PPI	% yoy aop	13.2	31.5	20.9	8.6	3.1	7.8	20.4	16.8
PPI	% yoy eop	35.4	15.7	20.8	0.9	5.7	11.2	24.1	9.6
Exports (gs, USD)	% yoy	-13.4	-7.9	17.9	9.5	10.7	24.0	42.6	7.5
Imports (gs, USD)	% yoy	-14.0	-19.1	18.9	14.1	4.9	28.7	31.3	20.4
Current account	USD bn	-1.3	0.9 ^o	1.2 ^{oo}	1.4	3.1	2.9	6.9	2.5
Current account	% GDP	-3.1	2.9 ^o	3.8 ^{oo}	3.7	7.6	5.9	10.6	3.0
FDI (net)	USD bn	0.7	0.5	0.6	0.8	0.7	1.4	1.7	6.5
International reserves	USD bn	0.79	1.09	1.48	3.09	4.42	6.94	9.52	19.39
Fiscal balance ^{'''}	% GDP	-2.7	-2.1	-0.7	-1.9	0.8	-0.2	-3.4	-1.82
Total state debt	% GDP eop	49.4	61.4	45.2	36.3	34.3	29.5	24.7	18.4
External debt (total)	% GDP eop	38.4	49.9	33.0	26.0	24.6	17.3	18.6	10.35
Monetary base	% yoy eop	21.9	39.3	39.9	37.4	33.6	30.1	34.1	53.9
Exchange rate	USD aop	2.45	4.13	5.44	5.37	5.33	5.33	5.31	5.12
Exchange rate	USD eop	3.43	5.07	5.44	5.30	5.33	5.33	5.31	5.05
Exchange rate	EUR aop	2.77	4.39	5.03	4.81	5.03	6.02	6.62	6.40
Exchange rate	EUR eop	4.02	5.20	5.10	4.67	5.53	6.66	7.22	5.97

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

^{'''} "Minus" denotes a consolidated fiscal deficit

^o 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

^{oo} 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