Monthly Economic Monitor Ukraine

- On December 9, Volodymyr Lytvyn was elected as the new Speaker of the Verkhovna Rada.
- Between January and October real GDP growth slowed to 5.8% yoy due to collapse in manufacturing and trade.
- Trade barriers and low demand prevented record grain exports.
- The NBU estimated current account deficit at USD 10.5 bn or 6.5% of GDP in the first ten months of 2008.
- Central fiscal deficit reached 0.3% of GDP between January and October.
- Consumer price inflation slowed to 22.3% yoy in November.
- Exchange rate may have found its bottom at 7.48 UAH/USD.

No.12 (98)
December
2008

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: Verkhovna Rada elected the new Speaker

On November 12, the Verkhovna Rada dismissed Speaker Arseniy Yatsenyuk from his position. The dismissal was initiated by the Party of Regions and supported by three other parliamentary groups - the Lytvyn Block, the Communists and partly by the pro-presidential "Our Ukraine" faction. Until a new speaker was elected, deputy speakers presided over parliamentary sessions. As deputy speakers do not have clear legal authority to sign passed laws, the Verkhovna Rada cannot function effectively till the Speaker is elected.

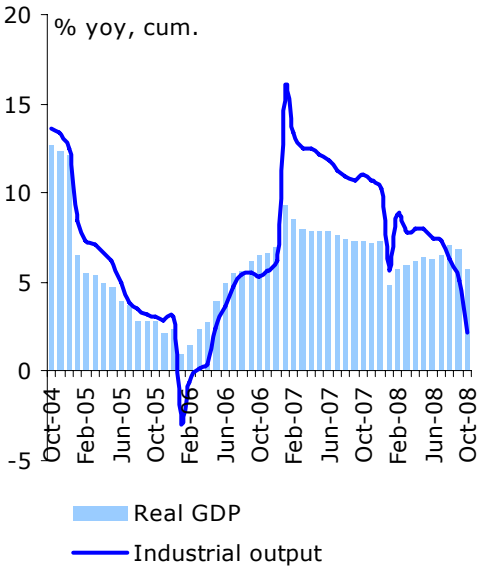
Centrist Volodymyr Lytvyn, unaffiliated Ivan Plyushch and communist Adam Martynyuk have been often mentioned as main contenders for the vacant position. On December 9, Volodymyr Lytvyn was elected as the new Speaker. In turn, he proclaimed the formation of new coalition among the BYUT, Lytvyn Block and "Our Ukraine".

Real sector: Decline in industrial production decelerated real GDP growth

Between January and October real GDP grew by 5.8% yoy, decelerating by 1.1 percentage points (p.p.) comparing to the first nine months of the year. Manufacturing suffered the most with value added deceleration by 3.0 p.p. to 2.9% yoy in real terms as domestic and external demand decreased for commodities, consumer and investment goods. Construction and trade continued their downward trends in October due to the credit crunch and falling real disposable income, while agriculture accelerated because of rich harvest of corn and sunflower mitigating blow to real GDP growth.

Industrial output growth slowed down to 2.2% yoy in ten months of 2008. Monthly industrial production in real terms has been declining for the third consecutive month and dropped in October by 19.8% yoy. Mining and metallurgy contracted the most due to fall in external demand and increased international competition. In particular, metallurgy output tumbled by 35.6% mom, while iron ore production fell by 27.3% mom.

Real growth rates of GDP and industrial production



Source: Derzhkomstat

Sectoral trends: Record harvest so far has not translated into higher exports

Agriculture. By the end of November crops harvest reached 54.2 m tonnes, demonstrating 85% yoy growth. The increase in production was registered for all major types of crops. As supply has exceeded domestic demand by far, the surplus had been expected to be exported. However, economic and administrative limits prevented crops exports at full capacity. In particular, the EU re-established the import duties for grains late in October, severely hitting the exports of feed corns. Also, Egypt prohibited imports of milling wheat of 2008 harvest from Ukraine late in November. These developments contributed to further decline in export volumes in November compared to the previous months steering the price down to production cost level. The ending crops stocks are now expected to be around 17 m tonnes, more than twofold jump from the previous year.

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In such circumstances agricultural producers are facing lack of own funds. Therefore, the success of spring seeding campaign now heavily relies on the ability of banks to finance the sector.

Privatisation. In November the President abolished his July Decree suspending the privatisation of JSC 'Odessa by-port plant'. Some experts estimate the fair value of the plant at around USD 0.7-1 bn. Though this figure is not likely to be reached under current economic circumstances, the sale could send a positive signal to investors and contribute to the Stabilisation Fund established as a part of anti-crisis package passed by the Parliament in late October.

Transport. The Cabinet of Ministers fixed transport tariffs for metallurgy and chemical industry till 2010. Such measure will be of little help to these sectors as transport costs are less than 10% of overall costs, but it considerably hurts transport sector and deepens cross-subsidisation among industries.

In November the state railways monopolist "Ukrzaliznytsia" signed two credit agreements for the purchase of new freight cars. Namely, the European Investment Bank agreed to lend EUR 175 m, and the EBRD promised to provide USD 125 m. It is expected that the funds will be disbursed in 2009. The efficiency of the projects will to great extent depend on how transparent the use of these funds will be.

External sector: Current account deficit reached USD 10.5 bn in ten months of 2008

According to the preliminary estimations of the NBU, the current account deficit continued to widen in Ukraine despite the devaluation of hryvnya, and reached USD 10.5 bn (6.5% of GDP) over ten months of the year. Current account deficit grew by USD 1.9 bn in October as monthly imports decreased less than exports, while negative balance of incomes increased.

Between January and October cumulative growth rates of commodity exports and imports in dollar terms remained quite high at 48.0% and 53.5% yoy respectively. However, already in October economic crisis resulted in deceleration of trade flows. Drop in world prices and demand damaged exports of metals, chemicals and machine building. Also high crops harvest caused only moderate boost in agricultural exports as low world prices and trade restrictions set by counterparts hindered trade. At the same time, hryvnya depreciation, falling domestic demand, and reduction of world commodity prices, including sharp drop in crude oil prices, resulted in lower imports.

Due to significant deceleration of net FDI inflow and outflow of foreign cash from banking system, in October the financial account balance turned negative to USD 2.1 bn. Though, cumulative balance of capital and financial accounts in the first ten months of the year remained positive at USD 12.7 bn.

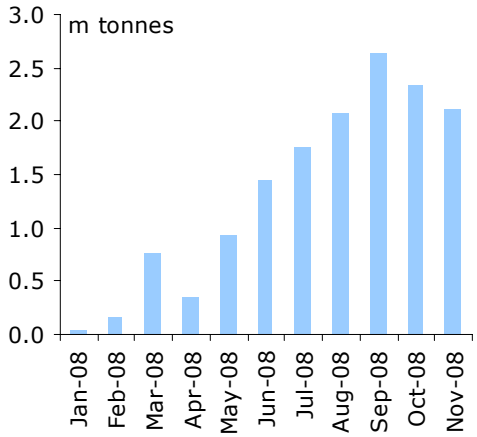
Fiscal policy: Central fiscal deficit reached 0.3% of GDP

Between January and October the central fiscal revenues exceeded the target by 6.5% mainly due to still higher than planned enterprise profit tax (EPT) receipts. Despite the economic slowdown, the EPT revenues were over-executed by 23.1% thanks to good financial results of previous months. The execution rate of VAT continued to gradually deteriorate due to low domestic VAT revenues (91.9% of the target). Still VAT collections remained 2.2% above the plan thanks to high VAT paid on imports as hryvnya devaluation partly offset lower import volumes. The execution of central fiscal expenditures improved to 96.9% of the target. The central fiscal deficit slightly increased to UAH 2.6 bn or 0.3% of GDP.

Social policy: Gloomy outlook for labour market

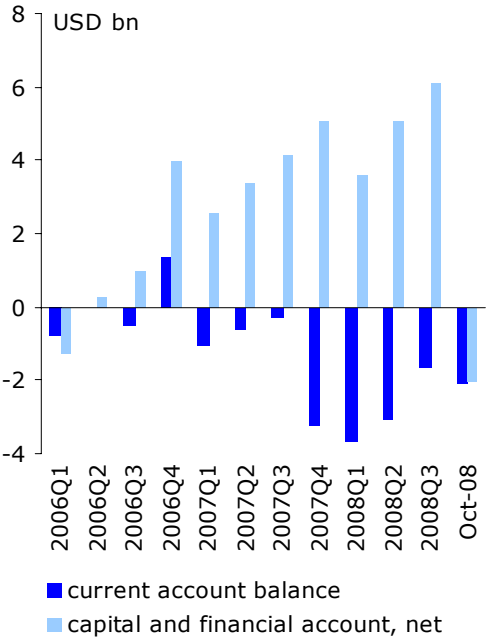
The deceleration of economic growth in the end of 2008 and expected downturn in 2009 shall increase unemployment, both open and hidden. As revealed by IER Business Tendency Survey of managers in manufacturing, employers are likely to implement several measures to restrict labour costs. Almost half of the respondents named

Grain Exports from Ukraine



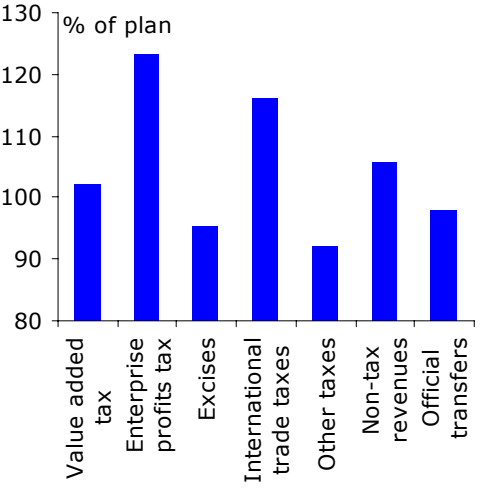
Source: Ukragroconsult

Balance of payments



Source: NBU

Central fiscal revenues execution in 2008*



* Between January and October
Source: State Treasury reports

shortened working time as anti-crisis measure, resulting in proportional reduction of wages of employees. Also, the practice of unpaid leaves could be renewed, though they are restricted by 15 days per year. Moreover, approximately 40% of managers claimed that they dismissed or plan to dismiss personnel due to the crisis. According to the official estimates, the unemployment rate (ILO) would increase to at least 7.7% in 2009.

Higher unemployment and restricted wage growth will negatively influence incomes of households and revenues of social insurance funds. It is expected that the Pension Fund and the Unemployment Insurance Fund will face large deficits in 2009 that will have to be financed through central fiscal transfers.

Monetary policy: Inflation decelerated to 22.3% yoy

Consumer inflation decelerated to 22.3% yoy in November. Despite high inflation expectations and increase in imported goods prices, limited demand and statistical base effect constrained the CPI increase.

Money supply growth decelerated in November to 32.2% yoy, while cash (M0) continued to grow rapidly due to deposit withdrawals from banking sector. Liquidity remained very tight, as hryvnyas were converted to US dollars or withdrawn from deposits, though the NBU continued to support cash-strapped banks through refinancing. By the end of November inter-bank interest rates went through the roof reaching 54.4% p.a. after the NBU announced that it will again require banks to maintain reserves only on correspondent accounts with the NBU, and forbid to include cash in bank vaults to required reserves. As of October 31, required reserves were UAH 12.7 bn, while cash in vaults was UAH 11.8 bn. The NBU also decreased reserve requirements by 50-100 basis points. Thus, the overall impact on liquidity will be softer.

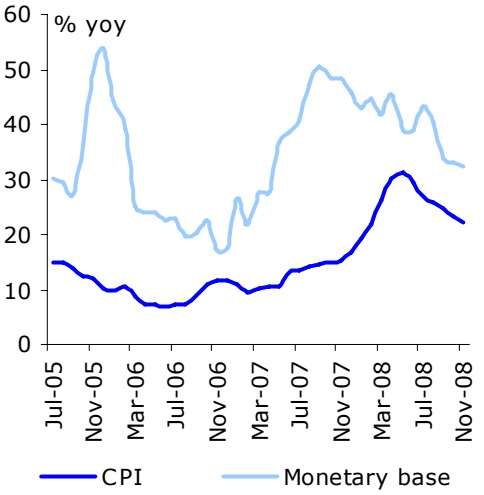
Financial markets: Hryvnya found its bottom so far

Exchange rate. In the first half of November the NBU maintained the exchange rate in narrow range of 5.76-5.80 UAH/USD. The interventions were successful for a short time, as the market became closer to a balance. However, later in the month the demand for foreign currency surged once again, partly driven by devaluation expectations. According to the terms of IMF loan, the NBU may spend only limited amounts to support hryvnya. Therefore, the NBU scaled down interventions and allowed hryvnya to depreciate to 7.48 UAH/USD or by 29.6% mom. In the end of November and first days of December, demand was balanced with supply without NBU interventions as exchange rate fluctuated in 7.3-7.5 UAH/USD range and devaluation expectations receded. Thus, hryvnya may have found its bottom for the moment.

State debt. In November the Ministry of Finance continued placement of domestic state bonds maturing in 2010-2011. The state bonds were placed at the total amount of UAH 7.0 bn allowing the Ministry to fulfil the annual plan of state bonds placement. Average yield of the bonds placed in November was 15.6% p.a. The major placements were made on November 6 and November 13 at UAH 3.0 bn each. These issues were bought by two state banks (Oschadbank and UkrEximBank) and then sold to the NBU at the secondary market (PFTS). The involvement of the state banks in the transaction and its speed allow classifying it as quasi-fiscal operation according to the IMF fiscal transparency rules.

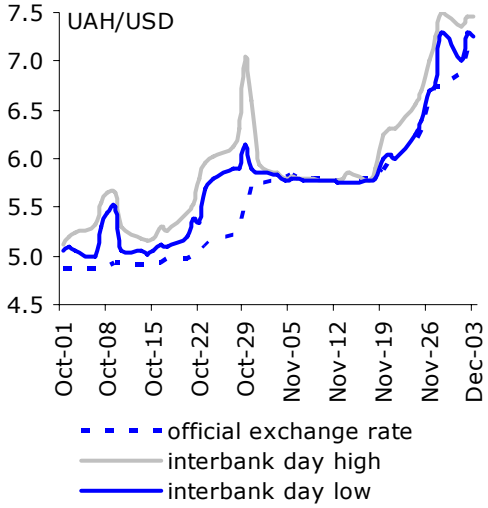
Banking sector. Raiffeisen Bank Aval, Creditprombank, PUMB and Nadra conducted regular due-payments for external loans in November. Almost all of them have attracted syndicated loans just before the financial crisis came into new phase, *de-facto* refinancing previous obligations. Nadra got support from the NBU to satisfy creditors' claims. Significant amount of external liabilities and problematic structure of credit portfolio in face of hryvnya devaluation pose additional risks on the banking system in Ukraine.

CPI and monetary base development



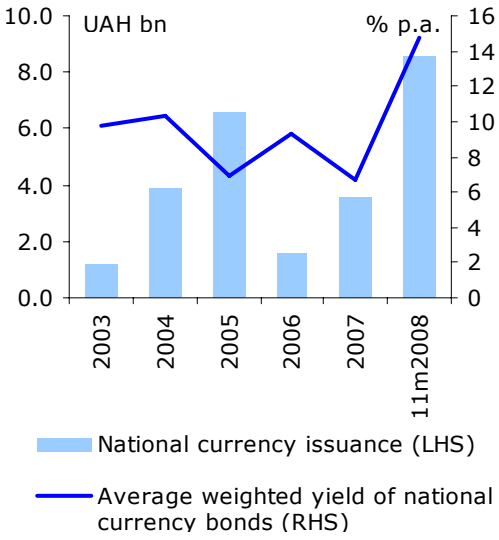
Source: Derzhkomstat, NBU

Exchange rate



Source: Reuters Investor

Issuance and average yield of state bonds in national currency



Source: NBU, Ministry of Finance, IER estimates

Economic Trends		Q1 07	Q2 07	Q3 07	Q4 07	Q1 08	Q2 08	Q3 08	Jun	Jul	Aug	Sep	Oct	Nov
GDP growth (real)	% yoy	8.9	8.6	6.2	7.4	6.5	6.5	…	5.4	7.3	10.9	5.5	-2.1	…
GDP growth (real)	% yoy cum.	8.0	7.9	7.3	7.6	6.5	6.5	…	6.3	6.5	7.1	6.9	5.8	…
Industrial production (real)	% yoy cum.	12.5	11.8	10.7	10.2	7.8	7.5	5.1	7.5	7.3	6.3	5.1	2.2	…
Agricultural production (real)	% yoy cum.	5.0	6.3	-5.1	-5.6	0.2	-0.3	15.1	-0.3	10.9	21.0	15.1	17.6	…
CPI	% yoy eop	10.1	13	14.4	16.6	26.2	29.3	24.6	29.3	26.8	26.0	24.6	23.2	22.3
PPI	% yoy eop	17.9	20.6	19.6	23.3	31.8	43.7	42.7	43.7	46.3	46.9	42.7	37.7	27.4
Exports (USD)***	% yoy cum.	32.4	32.4	27.3	27.4	28.5	41.1	…	40.7"	46.6"	48.5"	50.1"	48.2"	…
Imports (USD)***	% yoy cum.	32.0	33.2	31.5	34.8	45.1	52.9	…	55.3"	57.5"	58.3"	60.2"	57.0"	…
Merchandise trade balance	USD bn cum.	-1.74	-3.43	-6.12	-10.6	-4.6	-8.6	…	-9.8"	-11.1"	-12.5"	-14.3"	-16.4"	…
Current account	USD bn cum.	1.21	-1.98	-2.47	-5.9	-3.6	-6.8	…	x	x	x	x	x	x
Current account	% GDP, cum.	-4.6	-3.4	-2.5	-4.2	-9.6	-7.9	…	x	x	x	x	x	x
Gross international reserves	USD bn eop	22.9	25.9	30.6	32.5	33.2	35.5	37.5	35.5	37.9	38.1	37.5	31.9	32.7
Monetary Base	% yoy eop	27.7	38.4	50.6	46.0	41.4	38.9	33.0	38.9	41.6	40.2	33.8	33.1	32.2
Lending rate on UAH credits **	% pa, aop	14.0	13.9	13.7	14.0	14.6	17.2	17.1	17.3	17.1	17.3	16.8	19.1	22.6
Exchange rate (interbank)	USD aop	5.04	5.02	5.01	5.04	5.03	4.79	4.70	4.68	4.61	4.62	4.83	5.56	6.11
Exchange rate (official)	USD aop	5.05	5.05	5.05	5.05	5.05	4.96	4.85	4.85	4.84	4.84	4.85	5.04	6.00
Exchange rate (official)	EUR aop	6.62	6.81	6.93	7.31	7.56	7.75	7.31	7.45	7.64	7.29	6.99	6.75	7.56

Sources: Derzhkomstat, Ministry of Finance, NBU, IFS, Reuters, 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		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