Monthly Economic Monitor Ukraine

- Ukraine was granted an IMF stand-by loan to cope with the crisis.
- Between January and September real GDP growth slowed to 6.9% yoy as manufacturing and agriculture decelerated.
- Despite a large harvest, low prices and tight credit endanger financial conditions of agricultural producers.
- Current account deficit is estimated at USD 8.4 bn or 5.8% of GDP in the first three quarters of 2008.
- Consumer price inflation slowed to 23.2% yoy in October.
- Exchange rate suffered from extreme volatility with the peak at 7.05 UAH/USD on October 29.
- Measures have been taken to stabilise the situation in the banking sector.

No.11 (97)
November
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: The IMF agreed to provide stand-by loan to stabilize economic situation in Ukraine

On October 26 the IMF and Ukraine reached staff-level agreement to provide a USD 16.4 bn loan in 24-month stand-by arrangement. The IMF board approved it on November 5. The funds will be used to alleviate balance-of-payments difficulties and bail out troubled banks. In return, Ukraine undertook to adopt comprehensive economic policy package.

On October 20 the President suspended the parliament dissolution decree from October 9 to allow the Verkhovna Rada to pass emergency legislation to secure IMF loan and fight financial crisis. On October 31, politicians finally reached compromise and approved the rescue package. It includes three main parts: establishment of Stabilisation Fund, funded through debt issuance and privatization receipts that can be used to support real sector and banks; authorization of bank recapitalization by the state using cash and government bonds; and extension of tax privileges for agriculture.

As dire economic situation calls for some degree of political consensus and the source of funding for snap elections remains unclear, parliamentary elections are postponed for undefined time.

Real sector: Real GDP growth decelerated to 6.9% yoy

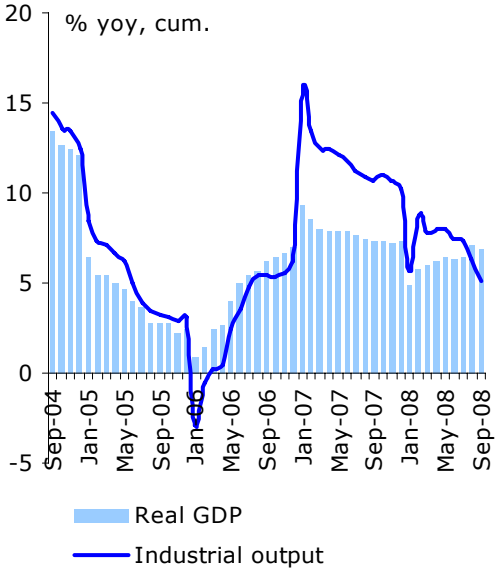
According to the Derzhkomstat, real GDP growth decelerated by 0.2 percentage points (pp) to 6.9% yoy in nine months of 2008 as compared to the eight-month growth under worsening conditions on world financial and commodities markets. Substantial slowdown of value added growth in mining, manufacturing and agriculture was caused mainly by falling prices and demand on metals and crops. At the same time, limited availability of credits and decline in real disposable income growth squeezed retail trade and construction sectors. Industrial production grew at 5.1% yoy in nine months of 2008 or 1.2 pp lower than in the period between January and August. In September, the most significant decline in output was recorded in metallurgy, coke production, and petroleum refining.

In the second quarter of 2008, real GDP grew at 6.5% yoy. The final household consumption decelerated to 13.3% yoy compared to 22.0% yoy in the first quarter due to the lacklustre demand as incomes and consumer loans suffered from tight monetary policy and high inflation. Higher interest rates on external debt caused deceleration of gross fixed capital formation to 6.3% yoy from 14.7% yoy in the first quarter of the year. The growth of real GDP was partly supported by substantial increase in inventories.

Sectoral trends: Bumper harvest does not save agricultural producers from financial woes

Agriculture. By the end of October, grain harvest in Ukraine reached 50.6 m tonnes or 73% more than in 2007. At the same time world and domestic prices for grain have kept on falling. During

Real growth rates of GDP and industrial production



Source: Derzhkomstat

Institute for Economic Research
and Policy Consulting
Reytarska 8/5-A, 01034 Kyiv
Tel. (+38044) 278-6342
Fax (+38044) 278-6336
E-mail: institute@ier.kiev.ua
http://www.ier.kiev.ua

October, domestic ex-works (EXW) prices for feed wheat fell by 32%, while prices for other types of grain decreased by 24% on average. On the other hand, world FOB prices dropped by 10-21%. Despite widening gap between FOB and EXW grain prices, exports were sluggish due to decreased demand. It created surplus on domestic market for feed grain, thus creating further downward price pressures. Falling prices against difficult situation in banking sector may prevent timely settlements with banks, creating obstacles for 2008/2009 marketing year seeding campaign and may result in lower grain harvest in 2009 than in 2008.

Privatisation. In October, the President unblocked privatization process of energy generating companies and Turboatom, nuclear power plant equipment company. At the same time he suspended the Government resolution transferring management of Turboatom, Odessa Portside-plant and a number of other industrial companies from the State Property Fund to the Ministry of Industrial Policy. Continued controversy over privatization and corporate governance in public sector limits its potential as source of funding for the Stabilisation Fund, the establishment of which was approved as a part of rescue package.

Energy. In October, NJSC Naftogaz Ukrainy and OJSC Gazprom (Russia) signed the agreement outlining the principles of long-term cooperation in gas trading. According to the contract, in 2009 Ukraine will receive gas directly from Gazprom while RosUkrEnergo that previously supplied gas to Ukraine as intermediary will be liquidated and the debt of Naftogaz to RosUkrEnergo for the supplied gas will be transferred to Gazprom. Liquidation of the intermediary should provide more transparency to the gas market.

Transport. In October the Cabinet of Ministers approved preferential freight tariffs for transportation of some inputs for metal and chemical industries till January 1, 2009, while other rail tariffs were increased: domestic passenger tariffs grew by 5%, international passenger tariffs by 20%, freight tariffs by 9.6%. Preferential tariffs for two sectors were officially aimed at mitigating the negative impact of the world economic crisis on these sectors. Such preferences seem insufficient to support metal and chemical production, while they hurt transport sector and deepen cross-subsidization among industries.

Telecommunications. The National Commission for Regulation of Communications increased monthly fee for home phones by 20% and radio usage fees by 50%. The measures were explained by higher input costs and low margins in fixed telecommunications.

External sector: Current account deficit reached USD 8.4 bn over the first three quarters of 2008

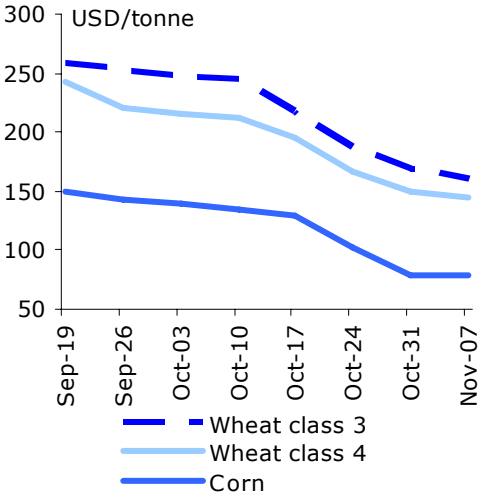
According to the NBU preliminary estimates over first three quarters current account deficit reached USD 8.4 bn (5.8% of GDP) as compared to USD 2.5 bn deficit a year ago. In the third quarter of 2008, the current account deficit was only USD 1.7 bn due to still favourable terms of trade, good harvest, and seasonal increase in balance of services. In the first nine months exports of goods grew by 50.0% yoy in dollar terms, and imports by 57.5% yoy. However, in September metal export growth slowed sharply already compared to July records both due to drop in prices and quantities exported.

Between January and September Ukraine managed to attract USD 8.9 bn as net FDI and around USD 5.8 bn in other capital inflows. The financial account surplus of USD 14.7 bn created some cushion for financing foreign exchange needs in the fourth quarter of 2008.

Fiscal policy: Central fiscal deficit was 0.1% of GDP

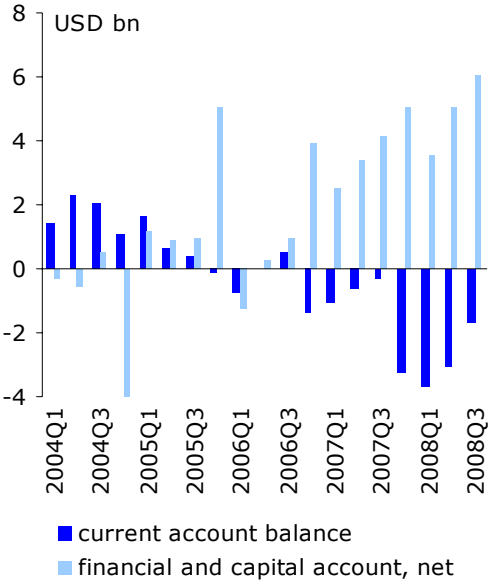
Between January and September the central fiscal revenues were over-executed by 7.2%. In particular, thanks to strong corporate profits accumulated in the previous months the enterprise profit tax revenues were above the plan by 21.1% despite the economic slowdown. The VAT revenues execution rate decreased substantially

Grain prices EXW in September-November 2008



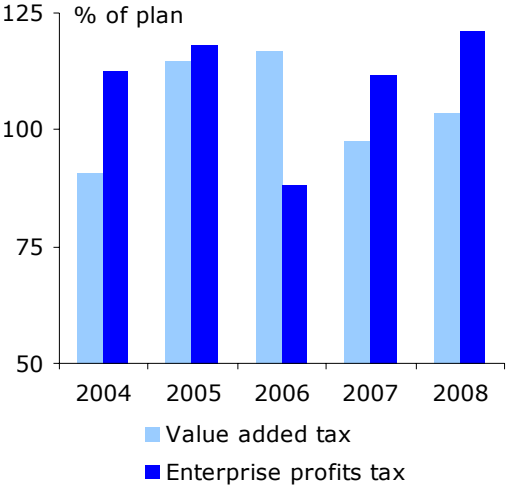
Source: IER calculations based on UkrAgroConsult data

Balance of payments



Source: NBU

Key tax revenues for January-September



Source: State Treasury, Derzkomstat

to 103.7% due to low domestic VAT revenues (92.4% of the target), while the VAT from import remained strong and reached 126.6% of the target. The central fiscal expenditures execution improved to 94.5% of the planned amount. The central fiscal deficit remained low at UAH 0.7 bn or 0.1% of GDP.

Social policy: Wages take a hit as economy slows

Between January and September real wage growth decelerated in all sectors of the economy with average rise at 9.1% yoy. In particular, the growth of wages in industry slowed to 6.8% yoy. In September nominal wages decreased as compared to August in extractive industry, metallurgy, construction and financial sector. Besides, some enterprises reported about the temporary lay-offs and shorter working weeks.

Monetary policy: Inflation decelerated to 23.2% yoy

In October consumer inflation decelerated to 23.2% yoy. Despite high inflation expectations and growing administered prices, limited demand and statistical base effect constrained the CPI increase.

Money supply growth decelerated sharply in October to 35.2% yoy, as cash (M0) supply surged due to deposit withdrawals from banking sector. Liquidity in October was very tight as some banks hoarded cash under increased uncertainty in counterparties, while others faced liquidity problems. Reacting to the financial sector problems the NBU provided one-year refinancing to several banks amounting to UAH 10.2 bn. The NBU also approved emergency measures intended to stabilise banking system including eased reserve requirements and special refinancing facility. Moreover, the NBU and the Government turned to the IMF for support and received USD 16.4 bn loan to cover balance of payments imbalances and recapitalise Ukrainian banks.

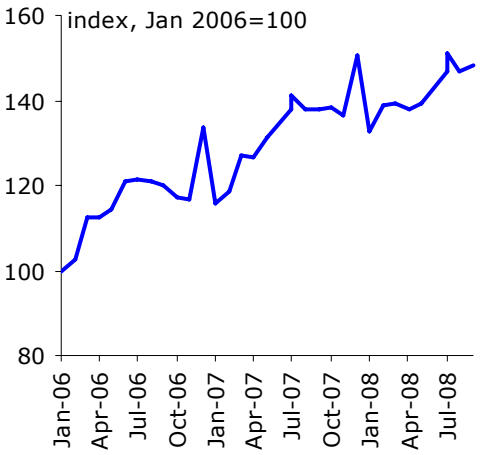
Financial markets: Currency crisis in the making

Exchange rate. October was marked by extreme volatility on foreign exchange markets. Decrease in supply of foreign currency, as exports slowed and capital inflows ceased, combined with increased demand caused jump in exchange rate. Further pressure was created by increasing reluctance of exporters to repatriate export revenues and by the surge in demand for foreign cash. Rather erratic interventions of the NBU that were conducted selectively and at below-market prices didn't contribute to market stability. Inter-bank exchange rates shot from 5.06 UAH per USD on October 1 to the peak of 7.05 UAH/USD on October 29. At the end of the month NBU stabilised market by offering unlimited supply of U.S dollars at rates close to UAH 5,80 per US dollar.

Banking sector. To stabilise the situation in banks against massive deposit withdrawals and tight liquidity, on October 11 the NBU imposed a number of restrictions on banking sector. Increase in bank assets was mainly forbidden, foreign currency lending was severely limited, while deposit withdrawals for time deposits before maturity were banned. These measures helped stabilizing the sector in the short-term, but long-lasting restrictions on deposit withdrawals would hamper confidence in banking sector. Also, as restrictions on active operations undermine medium-term viability of banks, they were quickly cancelled.

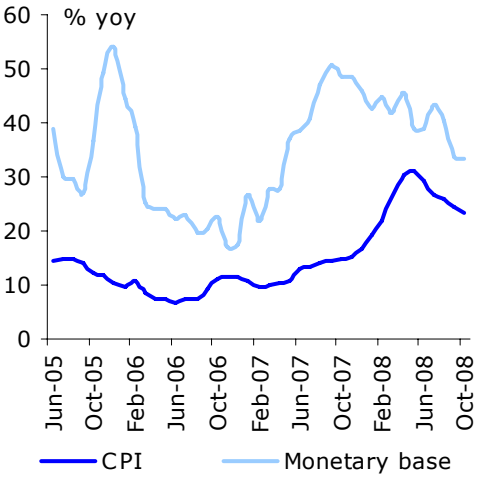
On October 31 Verkhovna Rada passed the law providing for bank bail-out by the state. According to the law the state is allowed to purchase stakes in banks if the NBU determines that recapitalization is necessary and bank is not able to attract sufficient private capital. The government investment in banks may be conducted through budget appropriations or by injections of government bonds, which will be subsequently acquired by the NBU. The Government will get majority stakes in banks. While solvency of banks that are too large to fail is crucial for the economy, the public officials may face significant conflicts of interest during bail-out process.

Real wage index



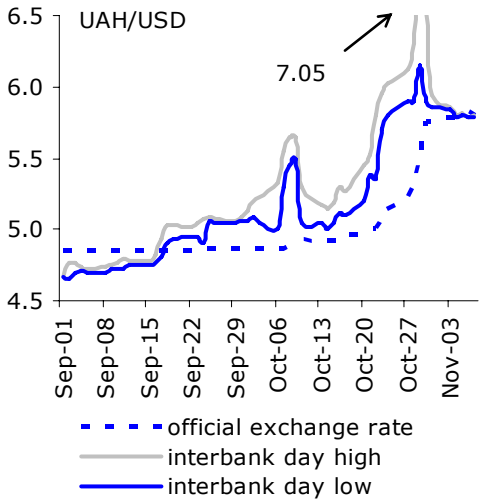
Source: Derzhkomstat

CPI and monetary base development



Source: Derzhkomstat, NBU

Exchange rate



Source: Reuters Investor

Economic Trends		Q1 07	Q2 07	Q3 07	Q4 07	Q1 08	Q2 08	Q3 08	May	Jun	Jul	Aug	Sep	Oct
GDP growth (real)	% yoy	8.9	8.6	6.2	7.4	6.5	6.5	…	7.2	5.4	7.3	10.9	5.5	…
GDP growth (real)	% yoy cum.	8.0	7.9	7.3	7.6	6.5	6.5	…	6.4	6.3	6.5	7.1	6.9	…
Industrial production (real)	% yoy cum.	12.5	11.8	10.7	10.2	7.8	7.5	5.1	8.0	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	0.2	-0.3	10.9	21.0	15.1	…
CPI	% yoy eop	10.1	13	14.4	16.6	26.2	29.3	24.6	31.1	29.3	26.8	26.0	24.6	23.2
PPI	% yoy eop	17.9	20.6	19.6	23.3	31.8	43.7	42.7	39.4	43.7	46.3	46.9	42.7	37.7
Exports (USD)***	% yoy cum.	32.4	32.4	27.3	27.4	28.5	41.1	…	35.8"	40.7"	46.6"	48.5"	50.1"	…
Imports (USD)***	% yoy cum.	32.0	33.2	31.5	34.8	45.1	52.9	…	52.3"	55.3"	57.5"	58.3"	60.2"	…
Merchandise trade balance	USD bn cum.	-1.74	-3.43	-6.12	-10.6	-4.6	-8.6	…	-8.8"	-9.8"	-11.1"	-12.5"	-14.3"	…
Current account	USD bn cum.	1.21	-1.98	-2.47	-5.9	-3.6	-6.8	x	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	x
Gross international reserves	USD bn eop	22.9	25.9	30.6	32.5	33.2	35.5	37.5	34.4	35.5	37.9	38.1	37.5	31.9
Monetary Base	% yoy eop	27.7	38.4	50.6	46.0	41.4	38.9	33.0	38.8	38.9	41.6	40.2	33.8	33.2
Lending rate on UAH credits **	% pa, aop	14.0	13.9	13.7	14.0	14.6	17.2	17.1	17.5	17.3	17.1	17.3	16.8	19.1
Exchange rate (interbank)	USD aop	5.04	5.02	5.01	5.04	5.03	4.79	4.70	4.74	4.68	4.61	4.62	4.83	5.56
Exchange rate (official)	USD aop	5.05	5.05	5.05	5.05	5.05	4.96	4.85	4.99	4.85	4.84	4.84	4.85	5.04
Exchange rate (official)	EUR aop	6.62	6.81	6.93	7.31	7.56	7.75	7.31	7.76	7.45	7.64	7.29	6.99	6.75

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