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UKRAINE - Economic Situation and Prospects

Dr. Edilberto Segura

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International Debt Issues and the IMF Program

With the agreement of 99% of its creditors, Ukraine has now completed the restructuring of US$2.6 billion of its foreign private debt. It has now listed two new seven-year eurobonds, one denominated in euros and the other in dollars. Total debt service for year 2000 will now fall from US$3.2 billion to US$2.2 billion. Of this amount, about US$930 million are due to the International Monetary Fund, and US$150 million to the World Bank.

The success of this debt-restructuring program was a necessary, but not sufficient condition to address the country's debt issues. It gave Ukraine some breathing space on its external financing issues. But current debt service obligations -- at US$2.2 billion for year 2000 -- are still large when compared to its international reserves of US$900 million**,** as of April 30. The resumption of IMF lending is critical to serve large repayments due in June/July. Lack of IMF support will result in a major weakness of the Hryvnya, as international reserves would be used to serve debt. The level of reserves may fall to below US$500 million by the end of the year, even if the NBU were to purchase dollars in the open market. This would lead to lack of confidence and may abort the recent economic recovery.

The IMF has set two conditions for the resumption of IMF financial support. The first one is a positive result of the ongoing investigation that the NBU misrepresented its international reserves and misused IMF funds in 1996-98. The audit is being carried out by PricewaterhouseCoopers in two phases. The first phase reviews transactions carried out from July 1997 to January 1998. The findings of this phase were released on May 4. The second phase reviews the situation from November 1996 to July 1997. This second audit report will be available in June 2000.

Based on the information provided in the May 4 release, it would appear that because of the inclusion of assets which should not have been included in calculating international reserves, NBU's reserves were potentially overstated by an amount that varied from US$391 million in September 1997 to US$713 million in December 1997. The report also confirms that, by giving a misleading impression of the size of Ukraine's reserves, Ukraine received US$200 million of IMF disbursements that it might not otherwise have been able to obtain.

On the positive side, the audit report confirms that, with the exception of a US$15 million loan that the NBU has declared non-performing, the NBU received all the money it was due under the transactions that the NBU carried out. Furthermore, within the scope of the special audit examination**,** no evidence of misappropriation of Ukraine's reserves was found. These are very important conclusions in favor of the Prime Minister, who used to be the Chairman of the NBU at that time, even though the auditors reported that some of the non-Ukrainian banks have not confirmed their transactions with the NBU as requested. Based on the report that no misappropriation of funds took place, the Government is trying to convince the IMF to resume its lending, without waiting for the June report.

The second IMF condition to resume its lending is that the Government should meet its program commitments regarding budget revenues and economic reforms. The fulfillment of this condition may take some time, probably until June this year. The Government will need to get Parliament approval of about 30 tax laws that are needed to validate the tax revenue projections in the Fiscal Budget for year 2000. Otherwise, the fiscal deficit for 2000 will significantly exceed the target level of 1.5% of GDP. In addition, the Government will need to implement a number of economic reforms, including the following key ones: (a) increase housing and communal tariff to cover 100% of the costs of these services; (b) eliminate or reduce substantially barter transactions which today encourage tax evasion and corruption; (c) close-down a number of public enterprises that are bankrupt, within the framework of the new law on bankruptcy; (d) cancel export duties in all products, including sunflower seeds; (e) implement reforms to improve efficiency in the energy sector, including the auctioning for cash of all natural gas received by Ukraine as transit payments; (f) approve the year 2000 Privatization program, that should include a large number of energy sector companies; (g) further liberalize the agricultural sector, particularly by facilitating land privatization, leasing and sale; by phasing out the Government from the direct supply of inputs to agriculture; and by privatizing grain elevators; (h) adopt changes in the Law of the National Bank of Ukraine to ensure independent monetary and exchange rate policy.

If the IMF renews its lending, the World Bank would disburse US$70 million under its Coal Sector Adjustment Loan. In addition, US$100 million would be disbursed under its Financial Sector Adjustment Loan, provided that the following reforms are implemented by June 30: (a) establishment of a deposit insurance program; (b) approval of the new Law on Banks; and (c) completion of the restructuring of the Savings Bank.
Another US$100 million from the World Bank may be available later in the year under a new adjustment loan.

Economic Reforms

Prime Minister Viktor Yushchenko continues to enjoy wide support for its economic reforms. In early April, Parliament approved the Government's Reform Program for the next three years ("Reforms for Prosperity"). This program outlines the main social and economic reforms needed in the country, including measures to improve efficiency in the Government, reform the legal system, consolidate economic and currency stability, gradually relief undue tax pressures, further liberalize the economy, facilitate entrepreneurship, facilitate land privatization, settle wage and pension arrears, and integrate Ukraine into the European Union. It has been well received by the international community in Kiev.

The prospects for reform were also enhanced by the outcome of the April 16 National Referendum. President Kuchma won popular backing for a more powerful Presidency that would be able to push economic reforms more quickly through Parliament, which had consistently obstructed them. The Referendum gave the President significant political leverage and if the Constitution is changed according to the Referendum, the following changes will take place: (a) the President can dismiss Parliament if it fails to pass the Fiscal Budget within three months of its submission, or if Parliament fails to form a Majority; (b) an Upper House would be created, which would included Regional Representatives, who are likely to be supportive of the President; (c) the number of Deputies would be reduced from 450 to 300; and (d) it would remove the right of Deputies to immunity from prosecution.

Economic Prospects

As discussed in the March 2000 Activity Update, all indications are that the year 2000 may become a turning point, with the economy finally turning around. During the first quarter of 2000, GDP grew by 5.6% compared with the same period of 1999. This was the first y-o-y rise since independence. Industrial output was up 9.7% during the same period.

As expected, the rate of inflation has declined in the last few weeks, with an inflation rate of 1.7% in April, compared to inflation rates of 4.6% in January, 3.3% in February, and 2% in March 2000.

The economic forecast for year 2000 presented in the March 2000 Activity Update are still valid, provided that the IMF were to resume its lending by mid-year. A summary of key economic indicators and projections are given below:

Key Economic Statistics

	1996	1997	1998	1999	2000(p)
GDP					
Real GDP	-10	-3.0	-1.7	-0.4	1.0
GDP (UAH bn)	81	93	104	127	156
GDP/Capita (US$)	870	990	850	623	540
Savings (%GDP)	20	19	18	22	22
Investments (%GDP)	23	21	21	19	20
Public Finances					
Fiscal Balance (%GDP)	-3.2	-5.6	-2.7	-2.4	-1.5
Revenues (%GDP)	37	38	36	33	26

Expenditures (%GDP)	40	44	38	35	27
Monetary Statistics					
Consumer Prices (%YOY)	40	10	20	19	19
Monetary Base (%YoY)	38	45	22	37	15
Money Supply-M3 (%YoY)	35	34	25	40	18
Exchange Rate (UAH/$)	1.9	1.9	3.4	5.2	6.5
Balance of Payments					
Goods Exports (US$bn)	15.5	15.4	13.7	12.1	12.5
Goods & NFSE (US$bn)	20.3	20.4	17.6	15.8	16.3
Goods Imports (US$bn)	19.8	19.6	16.3	12.2	12.9
Goods & NFSI (US$bn)	21.5	21.9	18.8	14.4	15.4
Trade Balance (US$bn)	-4.3	-4.2	-2.6	-0.2	-0.4
Current Acc. Balance (US$bn)	-1.2	-1.3	-1.3	1.0	0.6
Direct Investments (US$bn)	0.5	0.6	0.7	0.7	0.9
Gross Reserves (US$bn)	1.9	2.3	1.0	1.2	1.3
Public Debt					
External Debt (US$bn)	8.8	9.6	11.5	12.5	13.0
External Debt Service (US$bn)	1.2	1.2	1.8	2.0	2.2
Domestic Debt (US$bn)	1.3	4.6	3.7	3.9	3.9