THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

Ukraine - Economic Situation

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September 2001

Economic Growth.

The last two months were remarkable ones for the agricultural sector of Ukraine. From January to July 2001, agricultural output increased at an exceptionally high rate of 24.6% year-to-year, compared to 4.8% in the first half of the year 2001. With the harvesting season almost completed, grain output is now likely to reach about 37 million tons in 2001, compared to about 24 million tons in 2000, an increase of 54%.

The excellent performance of the agricultural sector was the main driving force behind the very high GDP growth rates in recent months. In August this year, GDP grew by 12.4% compared to the same month last year. For the entire period January-August 2001, GDP grew by 10.8% compared to the same period last year. This is one of the highest rates of growth in the world.

Industrial output is performing relatively well. In comparison with the previous month, in July 2001 industrial output actually declined by 1.5%, but it grew by 13.5% when compared with July 2000. During the eight-month period from January to August 2001, industrial output grew by 16.9% year-to-year. The fastest-growing industries were the domestically oriented sectors, including machine building, food processing and textile/apparel. Due to worsened condition on external markets, especially Russia, it's expected that the contribution of export-oriented industries (metals/metal products, chemicals) into industrial output will gradually decline while that of inward-oriented ones will rise.

Fiscal Policies.

During the first seven months of the year, from January to July 2001, the Government's consolidated fiscal budget showed a surplus (including privatization revenues). This was achieved thanks to the good performance of consolidated fiscal revenues, which exceeded by 4.4% the original targeted amount. Consolidated fiscal expenditures were kept at about the planned levels.

The increase in consolidated fiscal revenues was due to a good collection of income taxes and other taxes gathered at local levels, which was associated with rising GDP and improved enterprise performance. The central budget figures, on the other hand, were less positive due principally to low privatization proceeds. By the end of August, only UAH 1.8 billion had been transferred to the budget, while the annual privatization target is UAH 5.9 billion. This target will not be met. This shortfall, however, will not affect the fiscal deficit as defined by the IMF (in accordance with the IMF methodology, privatization proceeds are not fiscal revenues, but sources of finance). The Government is now expecting to secure sufficient financing from the IMF, World Bank and other institutions to cover part of the privatization gap. If this financing is not fully available, Government expenditures will need to be reduced.

Monetary Policies.

Since the beginning of the year, monetary policy has been influenced by two factors. First, it was influenced by the need to issue Hryvnias to allow the purchase of foreign exchange to serve foreign debt. And second, it was influenced by the need to provide liquidity to a growing economy. During the period January to August 2001, money supply (M3) increased by 19.3% (or 30% on an annual basis, compared to an original target of 19%). During the same eight-month period, the monetary base increased by 22.3%.

As noted in previous months, these relatively high rates of monetary assets so far have not led to high inflation rates. This is due in part to increases in the supply of goods, particularly foodstuff, associated by the ongoing economic recovery. It is also due to the increased domestic demand for Hryvnias associated with the ongoing growth in income. In fact, during the last two months, inflation was negative, at –1.7% in July and –0.2% in August. The major deflation took place in foodstuff. During January to August 2001, inflation was only 3.3% (or 5% on an annual basis, compared to an original target of 13.6% for 2001). However, it is likely that the substantial growth of monetary assets does contain a lagged inflationary potential and would have some impact on inflation during the rest of the year. On this basis, the NBU forecasts that the annual inflation rate will reach 12% this year.

From February to August 2001, the Hryvnia strengthen by 1.7% from 5.44 UAH/US$ to 5.35 UAH/US$. The recent tragic terrorist act in the US led to a large appreciation of the Hryvnia on September 11 and 12, when the exchange rate was below 5.0 UAH/US$ in the retail markets. However, by September 14, the exchange rate had move close to its previous level. Although the Hryvnia might depreciate somewhat during the rest of the year, this depreciation should not be major. On the one hand, there will be a slow down in exports of Ukrainian goods due to the economic deterioration of Ukrainian trading partners and the numerous antidumping investigations that have been launched by several countries on Ukrainian exports. But on the other hand, this decline in foreign exchange earning may be compensated by the increasing amounts of foreign exchange to be made available from the re-initiation of lending by the IMF and the World Bank, as noted below.

In July and August 2001, the NBU intervened heavily in the foreign exchange market to purchase sufficient resources to serve debt repayments and replenish its international reserves. As of mid-September, the NBU's gross international reserves reached $2.3 billion, the highest level of reserves since February 1998. Net international reserves (which excludes proceeds from credits by the IMF and other central banks) became positive in June 2001 and reached $380 million by the end of August. With the expected renewal of IMF/World Bank lending, the level of gross international reserves could reach $2.4-2.5 billion by the end of the year.

Government Debt.

With the net repayment of foreign debt since the beginning of the year, the total amount outstanding of foreign public debt was reduced from $10.8 billion on January 1, 2001 to $9.6 billion at present.

Following the successful restructuring of the Paris Club debt as reported in previous months, the Government has made further progress in the restructuring of other foreign debt. Tentative agreement has been reached on the repayment of about $280 million of bilateral debt due to Turkmenistan, which was suspended in March 2000. According to the agreement, 50% of the outstanding amount will be paid in cash and 50% in kind, particularly by the participation of Turkmenistan in investment projects in metallurgy, machine building and agriculture. Cash re-payments would follow similar conditions to those agreed at the Paris Club (a final maturity of 12 years, including 3-year grace period). The final agreement is expected to be signed in February 2002, when the debt restructuring agreements under the Paris Club would be signed.

There are also ongoing negotiations with Russia on $1.3 billion of gas debt due by Ukraine's Naftogas to Russia's Gazprom. The Ukrainian government has confirmed that Russia has accepted the size of the debt at $1.3 billion and to apply repayment conditions similar to the ones agreed by the Paris Club. Discussions are still ongoing of the degree of debt comfort that the Ukrainian Government of prepared to provide. Ukraine considers this debt to be corporate, not government liabilities, while Russia had demanded full Government guarantee of this debt as a condition for its restructuring. It has been reported that Ukraine would not accept government guarantees but might be prepared to provide some form of comfort by agreeing to take part in resolving any problems that may arise due to any disruption by Naftogaz in meeting its obligations.

International Trade and Capital.

During the first half of 2001, Ukraine has managed to maintain a favorable balance-of-payment position. Compared to the same period last year, it was able to double the size of the trade surplus in goods and services to $1.7 billion (compared to $859 million in the same period last year). The trade balance in goods alone reached $593 million in January-June 2001, compared to a negative balance of $320 million last year. The trade deficit in goods and services with the CIS countries was reduced from $1.3 billion in January-June 2000 to $792 million in the same period of 2001. The trade deficit with CIS countries was overcompensated by a $2.5 billion trade surplus with the rest of the world. During 2001, Ukraine's main exports have been in metal products, machinery and equipment, and dairy products.

As reported earlier, during the rest of 2001, Ukraine's trade surplus is likely to weaken due to a number of factors, including a recent change in VAT rules between Russia and Ukraine, a number of protectionist measures imposed by Russia and anti-dumping procedures launched in Russia, the US, Canada and the EU.

Regarding foreign direct investments, during the first half of the year, net of repatriations, net FDI reached only $269 million, which is 20% less than in the same period of last year. Although the economic situation has clearly improved, Ukraine's business environment remains of concern to foreign investors. Political uncertainties have also contributed to this poor performance.

IMF and World Bank Programs.

As reported last month, it is now almost certain that the IMF and the World Bank will renew its lending to Ukraine during the second half of September 2001. The IMF is likely to disburse $380 million in September under its EFF Program. A further $380 million could be made available in December 2001, if a November review of the Program is successful. The main condition for the December tranches would be the approval by Parliament of an acceptable fiscal budget for 2002 (with a deficit not exceeding 1.7% of GDP in accordance with the IMF methodology). During the year 2002, Ukraine may be able to receive three tranches for a total of $570 million, following successful reviews in February, May and August 2002.

The World Bank's Board of Directors is also certain to approve its Programmatic Adjustment Loan of $250 million in September 2001, with disbursements of $150 million in October and $100 million in December. A second PAL for $250 million is planned for 2002.