SigmaBleyzer

# UKRAINE - Macroeconomic Situation

Dr. Edilberto Segura

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## The Real Economy

Even though GDP has continued to decline, the last few months have seen a slight deceleration in the rate of decline. In April 1999, real GDP declined 2.2% compared to the previous month. In May, the decline was only 1.4%. During January-March 1999, GDP had declined 4.8%. These are early indications of a change in the downward output spiral started by the external trade shock that took place in the second half of 1998. Further improvement in output can be expected in the next few months. The Government expects that GDP will level off and start growing in the second half of 1999, even though GDP for the entire 1999 is expected to decline by about 2.5%. The improvement in output is the result of the liberalization in the foreign exchange market, which allowed renewed imports of industrial inputs and raw materials. Foreign exchange restrictions and reduction in imported inputs were a major cause of the reduction in output after the 1998 crisis.

## Inflation

During the months of January to March 1999, inflation was under control, with monthly rates of 1.5% in January, 1% in February, and 1% in March. Inflation in April and May increased from these levels, with the Consumer Price Index rising 2.3% in April and 2.4% in May. These rates in April and May, however, were below anticipated levels since inflation in May was expected to reach 4.0%, due principally to an increase in electricity and utility prices on April 1st. The core inflation rate, calculated excluding these volatile components, has remained fairly stable at below 1% per month. For the entire year 1999, inflation is not expected to exceed 30% pa. This would be a major stabilization achievement, given that the Hryvnia has depreciated by around 100% since the start of the crisis in August 1998.

## Exchange Rates

During the first quarter of 1999, the NBU followed strict monetary policies. In January 1999, the monetary base actually contracted and increased by a small margin in February and March 1999. As a result, exchange rate pressures have eased. With the approval of the EFF in late March 1999, the NBU started to remove the foreign exchange administrative controls imposed earlier. Foreign exchange was allowed to be traded in the over-the-counter interbank market. The NBU also lifted the restriction on the margin by which exchange rates may deviate from the official rate. In the end of June, the NBU will remove the restriction on prepayment under import contracts. These foreign exchange liberalization measures have resulted in some depreciation of the currency, to a level of 3.95 UAH/US$ in the official market, a level that has remained stable for over two months. With further liberalization of controls planned for the future, the exchange rate is likely to have wider fluctuations than in the past. Tight monetary policy, however, is likely to maintain the exchange rate from depreciating sharply, with a rate not exceeding 5.0 UAH/US$ expected by the end of this year.

32. The low Hryvnia liquidity, caused by tight monetary policies, has allowed the National Bank of Ukraine (NBU) to start purchases of foreign exchange in the inter-bank market. During the second half of May 1999, the NBU bought close to US$ 300 million in the open market. Further purchases took place in June. These purchases permitted the NBU to increase the level of NBU's liquid useable foreign exchange reserves to US$ 1,050 million by mid-June 1999. This level of reserves is about US$300 million above the minimum level agreed upon with the IMF.

To avoid utilizing its international reserves for the payment of foreign debt service obligations, on May 15, 1999, the Ministry of Finance made an offer to holders of a fiduciary loan issued through ING Baring to roll-over 80% of the US$ 162 million due on June 9. The remaining 20% of the amounts due would be paid in cash. Negotiations with ING Baring are still ongoing. The Government expects to reach a mutually agreed restructuring of this debt by the deadline of June 24, 1999.

**Fiscal Budget Situation**.

Weaknesses in Public Finance has been at the core of the economic difficulties experienced by Ukraine, despite the progress made in other economic areas. However, the 1999 Fiscal Budget approved by Parliament is probably the best so far undertaken by the Government since its independence. It envisages Consolidated Revenues amounting to 36.3% of GDP, and Consolidating Expenditures of 37.3% of GDP. The Fiscal Deficit would represent 1% of GDP, compared to deficits of 2.7% of GDP in 1998 and 5.6% of GDP in 1997. The 1999 Fiscal Budget contains many measures that are important to sustain macroeconomic performance in Ukraine, including increases in gasoline taxes that will permit increases in excise taxes from 1.2% of GDP to 2.3% of GDP, elimination of the tax for the Chernovyl Fund, computation of the value-added tax liability in an accrual basis, introduction of a 3% tax on the purchase of jewelry, introduction of an additional tax of UAH 100 on purchases of automobiles, and introduction of a tax of 1% on the purchase of foreign exchange.

During the months of January and February 1999, the consolidated budget of the Government showed a surplus of over UAH 100 million. During the first quarter of the year, the collection of revenues was 11% lower than planned, but the Government took measures to reduce expenditures accordingly, keeping the overall fiscal deficit for the quarter within planned levels. By mid-June, the fiscal deficit was under control and below the targets agreed upon with the IMF. This budget performance so far is quite encouraging, as there are no signals yet that fiscal discipline will not be maintained.

**(e) Balance of Payments Situation**

Due to the financial crisis of 1998, merchandise exports and imports in 1998 declined by about 18% from the levels achieved in 1997. Since imports declined more than exports, the deficit in the current account balance was only US$600 million, compared to deficits of around US$1.2-1.3 billion in 1996 and 1997.

During the first few months of 1999, the trade situation has been similar. In January-April 1999, exports fell by 14.2% compared to the same period last year, whereas imports fell by 22.7%. As a result of these trends. Ukraine may be able to have a balanced current account deficit in this year.

**IMF and World Bank Programs**

Based on the major progress achieved in economic stabilization, on March 26, 1999, the IMF Board of Directors agreed to re-establish the US$2.2 billion Extended Fund Facility (EFF). This led to disbursements in March 1999 of two tranches for a total of US$153 million. Subsequently, in May 27, 1999, the IMF agreed to increase the size of the EFF by US$366 million to compensate Ukraine for export losses to Russia that resulted from the 1998 financial crisis. As a result, the EFF has been increased to about US$2.6 billion. On May 27, the IMF disbursed an additional US$180 million (US$150 million from the "old" facility and US$50 million from the incremental facility). Further disbursements are expected at the end of June.

The World Bank has also continued to disbursed its current loans. At the end of April 1999, the World Bank extended to Ukraine a second US$ 40 million tranche of US$ 150 million Coal Sector Adjustment Loan. US$ 17.5 million of the tranche will be used for micro-credits to miners laid off during the restructuring of the coal mining industry while the rest will used as a state budget financing. By the end of June, The World Bank expects to disburse US$100 million under its Enterprise Development Adjustment Loan. By September 1999, it is expected that US$100 million would become available under the Financial Sector Adjustment Loan. Most of the conditionality for these two adjustment loans has been met.

The above resources should enable Ukraine to meet its foreign debt service obligations during 1999. However, the debt service situation in year 2000 is more complicated. In that year, two large Eurobonds will mature, involving total debt service of US$1.3 billion. In addition, other large debt service obligations will include US$ 900 million due to the IMF, US$200 million due to the World Bank, US$220 million due under Gazprom bonds, US$260 million due to Russian and Turkmenistan, and US$300 million due under publicly guaranteed debt. The total debt service due in year 2,000 will be US$3.2 billion (US$2.6 billion in principal payments and US$670 million in interests due), compared to US$2.0 billion in 1999.

In order to serve its foreign obligations, the Ministry of Finance has recently acknowledged that a larger proportion of the state budget in the year 2,000 will be required to repay foreign debt. As a second source of financing, the Government will seek to increase cash receipts from privatization of large state enterprises, particularly telecommunications and electric utilities. Thirdly, the Government believes that in the year 2,000, new foreign borrowing could be possible. Fourthly, the Government expects to negotiate, on a voluntary basis, the restructuring of some of the foreign debt due in the year.

It is likely that a combination of the above financing options will be able to address debt repayments in the year 2,000, provided that the Government continues to improve the investment climate in the country. The incoming Government after October 1999 will need to demonstrate the continuation of its commitment to economic reforms and to improve Ukraine's business climate.

## Key Economic Statistical Information

| | 1996 | 1997 | 1998 | 1999P |
|---|---|---|---|---|
| Real GDP (% change YOY) | -10 | -3.0 | -1.7 | -3.0 |
| GDP (UAH bn) | 81 | 93 | 104 | 132 |
| GDP per Capita (US$) | 860 | 980 | 810 | 670 |
| Fiscal Balance (% of GDP) | -3.2 | -5.6 | -2.7 | -1.0 |
| Fiscal Revenues (% of GDP) | 36.7 | 38.4 | 36.1 | 36.3 |
| Fiscal Expenditures (% of GDP) | 39.9 | 44.0 | 38.8 | 37.3 |
| Consumer Price Index (% change YOY) | 40 | 10 | 20 | 30 |
| Money Supply-M2 (% change YoY) | 32 | 38 | 24 | 20 |
| Exchange Rate (end of period, UAH/US$) | 1.89 | 1.90 | 3.43 | 5.00 |
| Merchandise Exports (US$bn) | 15.5 | 15.4 | 13.5 | 13.0 |
| Non-Factor Service Exports (US$bn) | 4.8 | 4.9 | 4.7 | 4.2 |
| Merchandise Imports (US$bn) | 19.8 | 19.6 | 16.1 | 15.5 |
| Non-Factor Service Imports (US$bn) | 1.6 | 2.3 | 2.5 | 1.9 |
| Trade Balance (US$bn) | -4.3 | -4.2 | -2.6 | -2.5 |
| GNFS Balance (US$bn) | -1.1 | -1.5 | -0.4 | -0.2 |
| Current Account Balance (US$bn) | -1.2 | -1.3 | -0.6 | +0.1 |
| Net Foreign Direct Investments (US$bn) | 0.5 | 0.6 | 0.7 | 0.6 |
| Gross International Reserves (US$bn) | 1.9 | 2.3 | 0.7 | 1.20 |
| External Public Debt (US$bn) | 8.8 | 9.6 | 11.5 | 12.6 |
| External Debt Service (US$bn) | 1.2 | 1.2 | 1.8 | 2.0 |
| Domestic Public Debt (US$bn equiv.) | 1.3 | 4.6 | 4.0 | 3.2 |