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UKRAINE - CURRENT MACROECONOMIC SITUATION

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POLITICAL SITUATION

- The forthcoming Presidential elections overshadow any other news about Ukraine. The most recent poll predicts that President Kuchma will get about 27-30% of the votes. This will placed him as the candidate with most votes; but will not allow him to avoid a second round of elections.

- If no major coalitions are formed in the near future, the second candidate is likely to be Ms. Vitrenko, with about 22-25% of the votes. If Ms. Vitrenko were to be the second candidate, Mr. Kuchma is likely to win the second round. If a major coalition of leftwing parties were to emerge, such as one with Mr. Moroz in the lead, this candidate could become second in the first round of elections. In this case, the outcome of the second round would be less certain.

- Most international observers are using the assumption that Mr. Kuchma would be re-elected. The major question is not this one, but the kind of government that he will institute and the depth of economic reforms that the new government will implement. There is consensus in the international community in Kiev that a major acceleration of economic reforms is needed for the country to revive growth and avoid international default.

The highlights of the current macroeconomic situation is as follows:

THE REAL ECONOMY

- There are strong signals that the economy is turning around. Industrial production grew by 18.1% in September 1999, compared to September 1998 (when the economy was at a low point after the crisis). In total, during January-September 1999, industrial production rose by 2.3% compared with the same period last year. Industries oriented towards the domestic market performed well, as a result of the import substitution effect of the hryvnia's real depreciation. Wood processing and food processing showed strong performances. The electricity industry also performed well, while the chemical and machine-building industries continued to decline. Services - a sector hit hardest by the Russian crisis -continued to stagnate with trade turnover and transportation volumes below their pre-fall 1998 peaks. Other sectors - such as agriculture - did not perform as well.

- GDP grew by 4.6% in September 1999 compared to September 1998. But for the period January-September 1999, GDP declined by 1.7% compared to the same period last year. For 1999 as a whole, GDP is expected to decline, but by a much smaller amount than previously anticipated. It is now forecast that GDP will decline by only 0.5- 1.0% in 1999 (compared to a decline of 1.7% in 1998). The year 2000 is expected to show a positive rate of growth.

- During January-August 1999, foreign trade fell 23.8% to US$ 14.4 billion, compared to the same period last year. Exports fell by 16.7% to US$ 7.2 billion, whereas imports fell by 29.8% to US$ 7.1 billion. As a result, the foreign trade balance was positive at about US$ 100 million.

Fiscal Situation

- In spite of the Presidential elections, the Government has succeeded in controlling its fiscal accounts. Up to the end of September 1999, Budget performance had remained largely in compliance with the targets set under the IMF Program. The consolidated budget deficit for January-August was UAH 1.6 billion compared to the 1999 EFF target of UAH 1.96 billion, or 1.25% of GDP.

- As required under the Constitution, on September 15, 1999, the Government submitted to the Parliament a draft 2000 budget providing for a consolidated budget deficit of 1.3% of GDP, based on the IMF methodology. Under the Ukrainian methodology, which puts privatization proceeds above the line, the draft budget has a surplus of 0.4% of GDP. The draft budget lowers the tax burden compared to previous years.

- However, a strong debate is expected in Parliament, since the draft budget did not take into account the requirements of the Parliament's Budget resolution adopted in July 1999, which prohibited the Government to prepare the budget with surplus (according to the Ukrainian methodology).

Monetary Situation and Inflation

- Despite strong money expansion during the Summer (base money and broad money increased 27% and 25%, respectively) inflation remained subdued throughout the summer. After a 1% deflation in July, which was caused by seasonal fall in food prices, inflation was 1% in August, and 1.4% in September 1999, bringing the cumulative inflation for the first nine months of the year to 10.1%. Price of manufactures have been rising fastest in recent months, partly due to an oil price jump in late July-early August, while prices of food and services were growing more slowly.

- Inflation so far has been lower than anticipated, due in part to the fact that the Government was not able to implement expected price increases in utilities and communal services. The expectation is that these increases will be implemented after the elections. In any event, most agencies have now revised downward their projections for inflation in 1999, with December-to-December inflation forecasts of about 17%-20%, depending on the timing of implementation of increases in utility prices.

- Although the foreign exchange market, after the August 1999 "fuel crisis", is relatively stable, the market is still putting pressures on the exchange rate. This has led to pressures on NBU to follow tight monetary policy and to take measures aimed at preventing speculation. In early September 1999 NBU announced moratorium for NBU lending to commercial banks. NBU continued to use deposit auctions as an instrument to absorb excessive hryvnias from the market. Many observers believe that, after the elections, there would be a significant depreciation of the Hryvnia.

- NBU continues to buy US dollars to replenish its foreign exchange reserves which reached the level of US$ 1.3 billion in mid-October 1999.

International Lending

- In early September 1999, the World Bank disbursed US$ 100 million, within the framework of Financial Sector Adjustment Loan for budget deficit financing. At the same time, the IMF released another enhanced tranche (US$ 185 million) of the Extended Fund Facility. This brought total disbursements from the IMF and the World Bank, since September 1998, to US$ 1.6 billion, or over 100% of current gross foreign exchange reserves.

- However, in October 1999, the IMF took the decision to postpone the release of the US$ 90 million tranche until after the Presidential elections, due to the decision by Ukraine to introduce certain export restrictions (including export taxes for sunflower seeds), and the lack of action on agreed upon price increases for utility and communal services.

- During a recent mission to Ukraine, the IMF has said that it will revive its lending program to Ukraine only after it agrees with the new Government on the Budget for the year 2000, the economic reforms to be undertaken by it, and the implementation of price increases in utility and communal services. In effect, this means that no IMF or World Bank disbursements are likely to take place until the first quarter of year 2000.

- In early September, Ukraine announced its intention to seek consultations with the Paris Club of official bilateral creditors to discuss a possible debt rescheduling operation. While the share of such creditors in Ukraine's external debt is low accounting for less than 10% of debt service due in 2000-2001, an agreement with the Paris Club could facilitate Ukraine's debt discussions with private creditors of the London Club. It is unlikely, however, that such discussion would take place before the new Government has put in place a stronger economic reform program.

- In year 2000, the Government will need to serve significant amounts of foreign debt (about US$ 3.2 billion in principal and interest rates are due). Upon appointment, the new Government will need to take quick action to deal with these repayments and avoid international default. As mentioned in previous occasions, the Government will need to accelerate privatization of state enterprises and deepen its economic reforms. These actions are needed, both, to bring resources and to increase international confidence. On this basis, the Government could attract the resources needed to serve its foreign debt, including from the international agencies and private foreign banks.

Economic Statistics

Taking into account recent developments, the key economic statistics for 1999 have been revised as follows:

Key Economic Statistical Information

	1996	**1997**	**1998**	**1999P**
Real GDP (% change YOY)	-10	-3.0	-1.7	-0.5
GDP (UAH bn)	81	93	104	128
GDP per Capita (US$)	860	980	810	625
Fiscal Balance (% of GDP)	-3.2	-5.6	-2.7	-1.3
Fiscal Revenues (% of GDP)	36.7	38.4	36.1	36.3
Fiscal Expenditures (% of GDP)	39.9	44.0	38.8	37.6
Consumer Price Index (% change YOY)	40	10	20	20
Money Supply-M2 (% change YoY)	32	38	24	22
Exchange Rate (end of period, UAH/US$)	1.89	1.90	3.43	5.00
Merchandise Exports (US$bn)	15.5	15.4	13.5	12.9
Non-Factor Service Exports (US$bn)	4.8	4.9	4.7	3.7
Merchandise Imports (US$bn)	19.8	19.6	16.1	13.7
Non-Factor Service Imports (US$bn)	1.6	2.3	2.5	2.4
Trade Balance (US$bn)	-4.3	-4.2	-2.6	-0.8
Current Account Balance (US$bn)	-1.2	-1.3	-0.6	-0.9
Net Foreign Direct Investments (US$bn)	0.5	0.6	0.7	0.5
Gross International Reserves (US$bn)	1.9	2.3	0.7	1.2
External Public Debt (US$bn)	8.8	9.6	11.5	12.8
External Debt Service (US$bn)	1.2	1.2	1.8	2.0
Domestic Public Debt (US$bn equiv.)	1.3	4.6	3.7	2.2