Ukraine - Economic Situation

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Economic Growth.

The Ukrainian economy has continued to show positive real rates of growth, with GDP growing at 5.0% in May 2000, compared to May 1999. From January to May 2000, GDP increased by 5.4% compared with the same period last year. Industry led the recovery, with industrial output increasing by 12.1% in May, and by 10.8% in January-May, compared with the same periods last year. The best performing industrial sectors included wood processing, the food industry and light industry, all of them with rates of growth of 32% to 37% in January-May 2000, over the same period last year. In the industrial sector, the only subgroup to show a negative rate of growth was the fuel industry.

The agricultural sector, on the other hand, has continued to underperform. During the first five months of 2000, agricultural output declined by 5.2%, compared to the same period last year. Although the weather played a role in this poor performance of agriculture, the main reason was the inadequate use of fertilizers and other agricultural inputs, due to lack of credit, both from foreign suppliers and from the Government.

For the rest of year 2000, real GDP should continue to grow, but it is like to desaccelerate as capacity utilization in key subsectors is reached. In any event, GDP growth for 2000 should be no less than 2%.

Fiscal Policies.

Despite the recovery of economic growth in this year and the robust first-quarter fiscal budget surplus, the country is now missing its fiscal balance targets due to shortfall in the collection of fiscal revenues. If these trends were to continue, the fiscal deficit might reach 2%-3% of GDP by the end of the year (IMF definition), compared to a 1.5% of GDP agreed upon in the initial 2000 Fiscal Budget.

To bring the fiscal budget under control, the Government needs to secure agreement from Parliament on 21 laws that would expand the tax base and eliminate a number of exemptions, including laws on real estate taxes, income tax, and local taxes and duties. Although draft laws were submitted to Parliament early in the year, they have not yet been enacted. The approval of these fiscal measures is a condition for the renewal of lending by the IMF.

Monetary Policies.

Due to the lack of an agreement with the IMF for the renewal of the EFF program, during the first six months of the year the NBU had to purchase US$710 million of foreign exchange in the open markets, in order to serve the country’s foreign debt. These purchases resulted in a relatively rapid increase of money supply by 17.9% during the first five months of the year (3.7% in May alone). The monetary base increased by 13.2% from January to May 2000.

These money supply increases led to a high inflation rate of 14.4% for January-May 2000 (2.1% in May 2000). During this period, prices for "paid services" increased by 20%, followed by "food prices", which increased by 15.6%. Whether or not inflation will be brought under control during the rest of the year will depend fundamentally on a tightening of monetary policies, which in turn will depend on the success of the Government in renewing lending by the IMF and World Bank, as discussed below.

In spite of the above-mentioned increases in money supply and the relatively high inflation rate, during the last five months of this year the exchange rate for the Hryvnia has remained quite stable at around 5.4-5.5 Hryvnias/US$. This stability has been the result of increases in money demand, associated with the high rate of growth of the economy. The stability of the Hryvnia may continue for the rest of the year, provided that the IMF/World Bank programs are renewed before large debt service obligation are due in the last quarter of 2000. As of mid-June, the liquid gross international reserves of the NBU stood at US$930 million, down from US$1.2 billion at the beginning of the year.

International Trade.

During January-April this year, the aggregate volume of foreign trade increased by 22% over the same period last year. Exports were 20% higher that in January-April 1999, whereas imports were 24% higher. The trade balance showed a deficit of around US$700 million. This deficit was offset by a positive balance on "services", which helped to maintain a positive current account balance. For the rest of year 2000, the ongoing recovery of exports to Russia and the strong growth in Asia and Europe should help in maintaining a positive balance in the country's current accounts.

Foreign Debt Situation.

Following the April 2000 rescheduling of private foreign debt, debt service obligations during the first half of the year were manageable and covered by reductions in international reserves and purchases by the NBU of foreign exchange in the open markets. However, debt service payments due in the fourth quarter of this year will be more difficult to accommodate, unless the Government succeeds in renewing lending by the IMF, the World Bank and the European Union.

Economic Reforms and the IMF Program

The Government of Prime Minister Viktor Yushchenko continues to enjoy support from the country's population. This has permitted the implementation of a number of important reforms, including the reform of the agricultural cooperatives. However, the Government has found difficulties in getting support from its loose right-center coalition in Parliament and from other vested interests to accelerate the pace of reforms in other areas, including tax measures to balance the fiscal budget, further liberalization of foreign trade, and reform of public administration. These difficulties have led to delays in securing the agreement of the IMF to renew its lending activities in Ukraine. They have also put questions on the durability of the current Cabinet.

An IMF mission visited Kiev from June 20-28, 2000 to review the possibility of reviving the EFF Program, which was suspended in September 1999. Although progress was made, at this stage, the IMF mission will not recommend to its Board of Directors the revival of the EFF program, since there are still a number of conditions that need to be carried out by the Government. The key conditions are (i) tax measures to balance the fiscal budget for year 2000; (ii) acceleration of privatization, including Ukrtelecom, to ensure fiscal receipts this year; (iii) further reform of the energy sector, including an increase in auctioning of natural gas; (iv) lifting of current foreign trade restrictions, including the abolition of export duties on sunflower seeds, raw hides and metal scrap; (v) enactment of the Law of Banks and Banking Activities; and (v) phase out of free economic zones. The IMF and the Government have stated that the renewal of the EFF program will not depend on the results of the ongoing audit of NBU activities.

A Government mission to be led by Finance Minister Ihor Mitiukov, will visit Washington in the second half of July to continue discussions on the EFF Program with the IMF. However, given the recession in August of the IMF Board, it is unlikely that the EFF Program will be renewed before September 2000.

Following the renewal of the EFF program, both the World Bank and the European Union may be able to renew disbursements under their current balance-of-payment loans. Revival of the EFF Program is also a condition for the restructuring of bilateral debt to the members of the Paris Club of creditors.