



Ukraine

Economic Situation

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Retrospective Review of 2000

1. In year 2000, Ukraine showed the most successful economic performance since independence. Some of the important achievement included:

- (i) A rising economy, with a 5.3% growth in GDP growth, and 12% growth in industrial output.
- (ii) Growth in real incomes by about 8.5%.
- (iii) An improved trade balance, with a surplus in the Goods and Services accounts.
- (iv) A deficit-free consolidated fiscal budget for year 2000.
- (v) Approval of a deficit-free fiscal budget 2001, on time and at satisfactory levels.
- (vi) Major reduction in barter operations by industrial companies from 33% of revenues in 1999 to 18% at present.
- (vii) Control of inflation during the second half of the year.
- (viii) Increase in the population's deposits in commercial banks by 45% since the beginning of the year.
- (ix) Elimination of Government intervention in the agricultural market and its commercialization.
- (x) Full settlement of pension debts and partial settlement of debts to budget employees.
- (xi) Avoidance of major unemployment problems.
- (xii) Renewal of lending programs by the IMF, World Bank, EBRD, and European Union.
- (xiii) Successful external debt restructurization.

2. On the other hand, the Government fell short of its objectives in a number of areas, particularly business deregulation, administrative reform, and reform of the energy sector.

3. Overall, the balance is quite positive with the Government going on the right economic path. The Government fully recognizes that, following a sound policy of financial stability, the next step is to focus on improving business conditions in year 2001, particularly by reducing state intervention in the economy. The Prime Minister has recently stated that this will be a policy priority for the Government next year. The Government believes that a serious liberalization of regulatory policy will generate a lot of interest for corporate financing. Furthermore, this liberalization policy will encourage a change in the structure of production to favor an increased share for small and medium business, which will expand the middle class of the country.

Economic Growth.

4. During November 2000, GDP continued to grow at a fast pace. GDP grew by 7.0% in November 2000, year-to-year. The rates of growth in October and September 2000 were 6.1% and 3.2%, respectively, compared to the same months in 1999. For the eleven months from January to November 2000, the rate of growth of GDP reached 5.4%, year-to-year.

5. The industrial sector continued to show the most significant increase in gross value added. For the eleven-month period to November 2000, industrial output grew by 12.6%, compared to the same period in 1999. The industries oriented at the domestic market continued to show the highest growth rates, including textiles and apparel, wood processing/pulp and paper, and food industry.

6. For the entire year 2000, both GDP and industrial output will be higher than previously anticipated by the Government, at about 5.3% for GDP (compared to earlier forecasts of 2.0-3.5%) and 12-13% for industrial output (compared to earlier forecast of 7%). In monetary terms, GDP for 2000 is likely to be around UAH 165 billion, or about US\$30 billion.

Fiscal Policies.

7. As of mid-December 2000, the planned level of fiscal revenues and expenditures of the consolidated fiscal budget for year 2000 had been fulfilled at UAH 42 billion (US\$7.7 billion equivalent), with a balanced position. This achievement shows the resolution of the Government to match expenditures to revenues, using tight financial discipline when needed.

8. The fiscal budget for year 2001 was approved by Parliament on December 7, 2000, on the basis of the draft budget submitted by the Government. This is an important achievement and the first time that the budget was approved before the beginning of the fiscal year.

9. Including privatization revenues, the approved consolidated fiscal budget for 2001 is balanced, with revenues and expenditures set at UAH52.0 billion (around US\$8.5 billion, or 26% of GDP.) Privatization revenues would amount to UAH5.9 billion. On the basis of the IMF methodology, which considers privatization revenues as an item below the line, the consolidated fiscal budget would have a deficit of 3% of GDP. The national budget also envisages a 25% growth in the salary of civil servants, and major reduction of wage arrears to public employees.

10. The major risk in the 2001 budget is the stability of revenues, given the proposed Tax Code that may lower tax rates (the income tax rate from 30% to 20% and the VAT from 20% to 15%). The Government has agreed with the International Monetary Fund to

preserve stable tax revenues, with any cuts in tax rates matched by increases in the tax base, so as to ensure revenue neutrality.

Monetary Policies.

11. Inflation. During the last few of the year months, inflation followed a declining trend, with inflation in November 2000 at only 0.4%. For the entire period from January to November, inflation was 23.8%, a relatively high rate driven by high inflation during January-June. During this period, the NBU had to expand money supply significantly to purchase US dollars to serve foreign debt. For the entire year 2000, Ukraine's inflation rate is expected to be about 25%, with foodstuff prices growing by 25.5%, nonfood prices - by 8.7%, and prices for paid services - by 30.8%.

12. The Exchange Rate. The exchange rate for the Hryvnia has continued stable at around 5.4-5.5 UAH/US\$. In fact, in the last 11 months, the interbank Hryvnia rate has declined only 4.5% from 5.2 UAH/USD to 5.4 UAH/USD. This stability follows two years of rapid currency depreciation: the Hryvnia rate dropped 50% in 1999, and it collapsed by 80% in 1998, following the Russian financial crisis.

13. International Reserves. Since mid-December 2000, the level of gross international reserves of the National Bank of Ukraine has increased substantially to US\$1.6 billion, as of the end of the year. This followed a relatively stable level of about US\$1.1 billion since the beginning of the year. The current level represents a two-year record level. The increase in reserves was facilitated by the purchased by the NBU of US\$106 million in mid-December, and the recent transfer of US\$248 million in loans from the International Monetary Fund (see below).

Government Debt.

14. As of November 1, 2000, Ukraine's Government debt stood at US\$13.8 billion, a decline of US\$1.5 billion since the beginning of the year. Foreign debt fell by US\$2.4 billion to \$9.9 billion. This foreign debt represents about 33% of GDP, a reasonable amount for a country like Ukraine. On the other hand, during the year, domestic debt increased by US\$1.0 billion equivalent to \$3.9 billion. The total public debt of Ukraine, external and internal, represents 46% of GDP.

15. Following the resumption of lending by the IMF, in January 2001, the Government expects to submit a proposal to its bilateral creditors at the Paris Club for the restructuring of this foreign debt. Initially, the Government was planning to restructures US\$500 million of this debt; but the amount to be restructured may now be higher. The initial discussions with the Paris Group would take place in April 2001, with expected agreement towards the end of the year.

16. Until mid-December, in the absence of foreign loans, in order to serve its international debt the Government had to purchased about US\$1.3 billion of foreign exchange in the open market. This purchases led to high inflation during the first half of

the year. With the recent resumption of international lending (see below), the country should be able to serve its obligations with little recourse to the purchase of foreign exchange. This should ensure financial stability on the inflation rate and on the Hryvnia exchange rate.

17. During the 2001 budget discussions, Parliament has set limits on Ukraine's public debt. In particular, the State is forbidden to extend guarantees for credits taken by commercial enterprises, except for those granted by international financial organizations. As of January 1, 2002, foreign debt should be no more than US\$10.8 billion and domestic debt should be no more than the equivalent to US\$3.9 billion.

International Trade and Capital.

18. In the first three-quarters of 2000, Ukraine's foreign trade in goods totaled US\$20.2 billion, an increase of 22.6% year-to-year. The country's surplus in trade in goods increased from US\$148 million on September 1, 2000 to US\$394.7 million on October 1, 2000.

19. During this period, exports of goods rose 23.9% year-to-year, to US\$10.3 billion, largely due to a 50% increase in the export of chemicals and a 40% increase in the export of metals and equipment. Ferrous metals accounted for 36% of overall exports, chemicals for 11%, equipment for 9%, and mineral fuel, oil and oil products for 5.5%.

20. During the same period, imports of goods rose 21.3% to US\$9.9 billion. Gas imports, which make up a quarter of overall imports, rose by 9%, and equipment imports, which accounts for 9% of imports, went up 40%.

21. Including Services, the total international trade of goods and services during January-September 2000 reached US\$23.8 billion (an increase of 19.2% over January-September 1999.) Exports of goods and services amounted to US\$12.9 billion (an increase of 17.5%) while imports were US\$10.9 billion (an increase of 21.3%). The surplus in goods and services reached US\$2.0 billion.

22. Foreign investment in the Ukrainian economy has also increased during year 2000. It reached US\$588 million in the first nine months of this year, bringing total foreign investment in Ukraine to US\$3.7 billion since independence in 1991. The level of foreign investments so far in year 2000 represents an increase of 18% over the levels achieved in the last two years.

Multilateral Programs

23. On December 19, the Board of Directors of the International Monetary Fund agreed to re-initiate lending to Ukraine. Following this decision, in late December 2000, Ukraine received \$248 million from the IMF. In addition, Ukraine will receive about US\$1.3 billion by September 2002, the new closing date for the Extended Fund Facility Program (EEF). Until that time, if performance conditions under the EFF Program are

met, Ukraine will receive seven quarterly tranches of \$190 million, after each successful IMF review mission.

24. The IMF based its decision on the encouraging signs in Ukraine over the past year, including a strong fiscal position in 2000, structural changes in the budget, a law passed on increasing the transparency of privatization, and the law on banking activities. In connection with future disbursements under the EFF Program, the IMF will seek improvement in the transparency of privatization, a reduction in the sunflower seed export duty, an increase in the tax base, and improvement on an array of structural and financial issues.

25. All official international lending to Ukraine had been stopped with the suspension of the IMF Program in September 1999. Since September 1999 to mid-December, Ukraine continued to service its obligations to the IMF, reducing its debt to the IMF by US\$1.3 billion to US\$1.8 billion. The renewal of the IMF program will also allow resumption of disbursements from the European Union, the World Bank, and other international financial organizations.

Outlook for 2001

26. The economic outlook for 2001 is quite favorable. GDP for year 2001 should grow by 4.5%, with industrial and agricultural output increasing by 8.5% and 5.0%, respectively.

27. The rate of inflation in 2001 should be relatively low, at around 13.5%, given the Government's commitment to a deficit-free fiscal budget, a modest planned 16% increase in money supply, and the resumption of lending from international financial organizations. The inflation rates were about 25% for 2000, 19.2% in 1999 and 20% in 1998.

28. Following agreements with the IMF, the exchange rate regime would be further liberalized during year 2001. This exchange rate liberalization is not expected to put major pressures in the Hryvnia, given the fiscal and monetary policies discussed above. The Government expects that the average exchange rate in 2001 would be 6.1 UAH/US\$. The Government also expects that the level of gross international reserves of the NBU will grow from the current level of US\$1.6 billion to US\$1.8 billion during 2001. This level of reserves could be achieved even though, during 2001, the NBU will need to use US\$1.7 billion of foreign exchange to finance re-payments on the Government's foreign debt.

29. This favorable economic outlook could be complicated by recent political uncertainties. President Kuchma has been accused by the Parliament's Socialist Party Leader, based on information provided by a former Presidential guard, of ordering subordinates to get rid of a local journalist. This journalist disappeared in September 2000 and his body was found recently. No ironclad proof has yet emerged, but a large portion of Parliament has now turned against the President. The outcome is uncertain and a political crisis might bring not only political, but also economic instability to the country.

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