THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

Ukraine - Economic Situation

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Economic Growth.

During the first half of 2001, the solid economic performance of Ukraine continued at an impressive pace. Real GDP grew by 9.1% during this period, compared to the same period last year. This outcome followed an excellent performance during year 2000, when GDP grew by 6%.

Industrial output continued to be the lead growth sector, with a rate of growth of 18.5% during the first half of 2001, compared to the same period in 2000. This achievement put Ukraine as the lead among the CIS countries in industrial output growth. It also placed Ukraine as one of the fastest growing countries in the world. CIS countries boosted their industrial production by 8.4% in the first half of 2001.

About 80% of Ukraine's robust GDP growth could be attributed to strong external demand (which may have accounted for 50% of GDP growth) and rising domestic demand (which contributed about 30% to GDP growth). The remaining 20% of GDP growth could be attributed to the growing integration in the formal economy of "informal" enterprises and activities.

Ukraine's export-oriented processing industries grew by 23.3% during the first half of the year, year-to-year. During the same period, wholesale and retail trade and construction posted a 13.5% and 9.1% year-to-year growth, respectively. From January to June, agricultural output expanded by 5.4%, year-to-year.

During the rest of 2001, economic growth is likely to slow down, due to the imposition of anti-dumping and other trade restrictions imposed by a number of countries and the introduction of a new VAT collection procedure for Ukrainian goods introduced by Russia. Nevertheless, GDP growth for 2001 is likely to reach 6.5% in 2001, and exceed the original Government target of 4%. Industrial output is also likely to exceed previous expectations, rising by over 12% in 2001. The agricultural sector is likely to show an excellent performance in 2001 with grain output reaching 35 million tons, compared to 24 million tons last year. About 6 million tons of this output is likely to be exported, placing Ukraine among the world largest grain exporters.

Fiscal Policies.

Fiscal budget policies continue to be sound, despite shortcomings in privatization revenues. Including privatization receipts, the consolidated fiscal budget for the first half of 2001 showed a fiscal surplus of $256 million or about 0.6% of the expected GDP for 2001. On the basis of the IMF methodology that excludes privatization receipts, the consolidated fiscal budget had a small deficit of 0.2% of GDP (compared to a target deficit of 3% of GDP for 2001). This favorable result was due to higher than planned budget revenues, principally from local budgets, which were induced by higher than expected GDP growth.

Budget proceeds from privatization of state enterprises reached only $315 million in January-June 2001, compared to planned proceeds of $480 million for this period. Given delays in the privatization of telecommunications and electricity companies, the annual privatization revenue of $1.1 billion for 2001 is now unlikely to be met. Most likely, privatization revenues in 2001 would reach about $600 million, a shortfall of $500 million from the target. The Government expects to cover this gap from higher fiscal revenues and from the re-initiation of lending by international financial institutions. In addition, fiscal expenditures will need to be cut to avoid potentially inflationary financing of the deficit.

Monetary Policies.

During the first half of the year, the NBU purchased $900 million of foreign exchange in the inter-bank market. These foreign exchange purchases are the main source of monetary expansion in Ukraine. During this period, Ukraine's money supply grew by 15.2% (or 33% on an annual basis), compared to an original target growth of 19% for the entire year.

This monetary expansion, however, has not resulted in high inflation rates, since it was absorbed by the expansion of the economy. In fact, during June and July, the monthly inflation rates were only 0.6% and -1.7%, respectively. The deflation in July was also due to lower foodstuff prices, which declined by 2.7% due to a plentiful supply of agricultural goods. During the seven months from January to July 2001, inflation has totaled only 3.5%. The Government's target inflation rate for 2001 is 12%.

The purchases of foreign exchange by the NBU have not resulted in a depreciation of the Hryvnia due to large supplies of foreign exchange from raising exports. On the contrary, despite the NBU's interventions, the exchange rate of the Hryvnia revalued slightly during 2001 from 5.44 UAH/$ to about 5.35 UAH/$. Market expectation for the rest of the year, however, calls for a weaker Hryvnia by the end of the year, due to the likelihood that exports may decline due to antidumping investigations and implementation of VAT on Ukrainian imports by Russia.

Foreign exchange purchases by the NBU have led to an increase in gross international reserves to $2.08 billion, the highest level achieved in the last three years.

Government Debt.

Ukraine's stock of external debt is modest at about $9.8 billion, or 30% of GDP. But due to the short maturity of this debt, its debt-servicing schedule is tight, with about $1.8 billion due in 2001. Of this amount, about $900 million are due during the rest of this year. Nevertheless, given the recent increases in the level of international reserves, the successful restructuring of Paris Club bilateral debt, and the likely renewal of IMF and World Bank lending (see below), the servicing of this debt is manageable.

International Trade and Capital.

Ukraine's foreign trade showed a $421 million surplus in Jan-May 2001. The surplus was originated by a significant expansion of exports. During this period, exports went up by 20% year-to-year to $6.5 billion, while imports grew by mere 2.6% year-to-year to $6.1 billion. The volume of foreign trade in goods grew by 11.2% year-to-year to the level of $12.6 billion for the first five months.

Russia is still the largest trade partner accounting for 25.6% of exports and 38.1% of imports. Other major trade partners are Italy and Turkey (5.2% and 4.6% of total exports respectively) and Turkmenistan and Germany (11% and 8.2% of total imports respectively). Chemicals, metals and minerals were the goods that were most actively exported while minerals and machinery led in imports.

Due to the factors noted earlier, the pace of growth of exports is likely to decline during the rest of the year. Nevertheless, at the end of the year, the current account should remain positive.

Despite solid economic performance, foreign direct investments in Ukraine have not increased. On the contrary, during the first half of 2001, FDI fell by nearly 40% year-to-year down to $253.4 million. The Government has not agreed to implement the measures recommended by the International Private Capital Task Force (IPCTF) to improve the climate for foreign direct investments. A Presidential Decree has instructed the Government to prepare, by October 1, 2001, a Program to implement these recommendations.

IMF Program.

Following successful discussions in Kiev with the IMF, it is now likely that the IMF Board of Directors will agree on September 14-15 to renew lending to Ukraine. During the next few weeks, the Government will need to confirm actions on three pending matters: (i) a reduction in Government expenditures in the 2001 fiscal budget of about $350 million to make up for shortfalls in privatization receipts; (ii) a proposal for the 2001 fiscal budget with a fiscal deficit of no more that 1.5% of GDP, according to the IMF methodology; and (iii) simplification of the current stringent registration requirements for grain exports. The Government has confirmed that these requirements will be met shortly. The IMF is likely to disburse $250 million by the end of September, with another $200-250 million by the end of the year.

World Bank Program.

The World Bank has also completed negotiations for its Programmatic Adjustment Loan. Its Board of Directors is scheduled to consider a loan for $250 million on September 18. The loan would be disbursed in two tranches: $150 million in second half of October and $100 million in November 2001.

Bilateral Debt.

On July 2001 Ukraine signed an agreement with key Paris Club of creditors (France, Germany, Italy, Japan and the US) on restructuring Ukrainian bilateral debt to the Club worth $580 million. This debt will be repaid over 12 years with a three-year grace period. The sum accounts for approximately 52% of Ukraine's current debt stock owed to bilateral official creditors. This agreement is expected to reduce debt service due to Paris Club creditors during 2001 and 2002 from an initial amount of around $800 million to around $285 million after rescheduling.

The signing of this document was a precondition for restructuring Ukraine's $270 million debt to Turkmenistan, another large creditor. Negotiations with Turkmenistan are ongoing.

With the restructuring agreement with the Paris Club, and the forthcoming re-initiation of lending by the IMF and World Bank, Ukraine will be well poised to maintain financial stability over the foreseeable future. If the Government is successful in implementing the program of structural reforms recommended by the IPCTF (particularly business liberalization, improvements in its legal framework and public administration reform), the current pace of economic growth is likely to be maintained over the longer term.