Ukraine - Economic Situation

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Economic Growth.

Reflecting deteriorated external conditions, during December 2001, the Ukrainian economy continued to slow down, with industrial output increasing by only 1.8% compared to December 2000. During January-November 2001, industrial output had increased by 15.4% compared the same period in the previous year. During the entire year 2001, industrial output increased by 14.2%, an excellent overall performance for the sector.

From January to November 2001, GDP increased by 9% year-to-year. For the entire year 2001, preliminary estimates indicate that GDP would have increased by about 8.7%, compared to an initial Government forecast of 4% for the year.

In 2002, Ukraine should be able to keep financial stability and proceed with economic growth, though at a lower pace than in 2001. Most analysts forecasts GDP growth in 2002 to be in the range of 3% to 5%. A GDP growth rate of 3% is projected by CASE, a growth rate of 4.5% is projected by ICPS, and a growth rate of 5% is forecast by the IMF in its World Economic Outlook for 2002.

The Ukrainian Government projects a 2002 GDP growth rate of 6% as the basis for its fiscal budget for 2002. This Government's forecast may be difficult to achieve. Lower estimates are more likely, due to the poor external demand environment caused by the ongoing world economic slowdown, the number of antidumping cases and trade sanctions imposed on Ukraine and the decreases in world prices for some of Ukraine's main exports. They also reflect the fact that the Ukrainian export supply potential, which has been a key source of GDP growth, is being exhausted.

There is a general understanding that Ukraine will need to revive investments to maintain a high rate of economic growth. Also, economic growth in Ukraine will heavily depend on external conditions, particularly in Russia which is its main trade partner.

In order to revive investments on December 11, at the request of the President, the Cabinet of Ministers approved a program to accelerate investments in the country. The Program includes a number of measures to improve Ukraine's business environment, as a precondition to attract investments. This Program follows closely the recommendations made last year by a Task Force on International Private Capital Task Force, chaired by SigmaBleyzer and which included a number of foreign firms and agencies operating in Ukraine. The details on the Plan of Action to implement this Program will be completed by March 2002.

Government Policies.

According to preliminary information, the consolidated fiscal budget for year 2001 was executed with a reasonable balance between expenditures and revenues (including privatization revenues). As noted earlier, this balance was achieved principally by over-performance in tax collections and strong control on expenditures, and despite poor privatization receipts. Privatizations in 2001 brought only UAH 2.1 billion ($400 million) to the budget compared to an original target of UAH 5.9 billion ($1.1 billion) for the year. Part of the UAH 3.8 billion shortfall in privatization revenues was recovered by strong tax collections. As a result, fiscal revenues fell short of its targets by only UAH 1.0 billion ($190 million) or 0.5% of GDP, a shortfall that was balanced by lower expenditures.

In spite of expenditure controls, the Government was able to reduce further wage arrears in the public sector, which declined by 28% from the level at the beginning of the year, to UAH 1.0 billion by December 2001 (wage arrears are now concentrated mainly in the coal industry and the sea transport and aviation sectors.) On the other hand, the Government failed to make timely payment for the reimbursement of value-added taxes (VAT) to exporters. At the end of the year, about UAH 1.9 billion of VAT reimbursements were overdue.

On December 20 the Ukrainian Parliament passed a bill approving the 2002 national budget. The approved budget contains a deficit of UAH4.3 billion, or 1.7% of GDP, in accordance with the agreements with the IMF. Planned proceeds from privatization in the amount of UAH 5.8 billion are not included as budget revenues, in accordance with the requirements of the IMF, but they are included as a financing item. To meet these privatization targets, the State Property Fund will prepare plans for the sale of 12 electric power distributors by March 1, 2002. The Government plans to sell 75% of its equity in Dniprooblenergo, Vinnytsiaoblenergo, Volynoblenergo and Zakarpattiaoblenergo; 70% of its shares in Chernivtsioblenergo, Krymenergo and Khmelnytskoblenergo; 65% of its equity in Donetskoblenergo, Kharkivoblenergo and Zaporizhiaoblenergo; 51% of its equity in Ternopiloblenergo, and a 46% stake in Cherkasyoblenergo.

The 2002 budget bill was signed by President Kuchma on January 3rd. The President's Administration, however, has expressed its concerns that the revenue figures included in the budget approved by Parliament may not be achieved and that fiscal expenditures are under-estimated. The level and expenditures and revenues in the budget approved by Parliament exceeded the original draft submitted by the Government by UAH 1.7 billion ($300 million or 0.7% of GDP). The President is also concerned that the approved budget ignores significant Government expenditures likely in 2002, including refunding of VAT reimbursements (which could amount to UAH 5.7 billion, including UAH1.9 billion now overdue) and some social benefits (that could reach UAH 7 billion.) To make up for this difference, the President's Administration believes that Parliament must soon approve the draft Tax Code, which would expand the tax base by eliminating a number of tax exemptions and privileges. The second reading of the draft Tax Code was approved by

Parliament last December, but the final approval is not expected until after the Parliamentary elections scheduled for March 2002.

Monetary Policies.

Monetary policies during 2001 were quite expansionary, with money supply (M3) growing by 42% during the year (compared to an initial target of 19% for the year). As reported earlier, however, this high monetary expansion was not reflected in high inflation which reached only 6.1% during 2001 (compared to an initial target of 13.6%), the lowest inflation level since independence. The lack of inflationary impact was due to the increase in money demand associated with the high rate of growth in the economy and increased confidence that financial stability will be retained.

Since December 2001, however, inflation has accelerated with a monthly rate of 1.6% (or 21% on an annual basis). The NBU has announced its intention to follow tight monetary policies in 2002 in line with a target for money supply (M3) of about 18% to 20% for the year. The NBU anticipates that the previous increases in money supply and the expected increases in power tariffs will generate an inflation rate of about 3.5% for the first quarter of 2002 (or about 15% on an annual basis). For the entire 2002, the Government anticipates that inflation will be contained to about 10%. This may be feasible if prudent fiscal and monetary policies are indeed implemented.

During 2001, the Ukrainian Hryvnia appreciated against the US dollar by 2.6%, reaching 5.3 UAH/$ at the end of the year. This appreciation benefited from the positive current account surplus achieved by the country and Government's prudent fiscal budget policies. The appreciation of the Hryvnia took place in spite of the fact that the NBU purchased more than $2.1 billion at the inter-bank market to build up international reserves and serve foreign debt.

At the end of December 2001, NBU's liquid gross international reserves stood at $3.1 billion, an increase of 90% from the level at the beginning of the year. At the end of November, the NBU's net international reserves had increased to $1.0 billion from minus $596 million as of January 1, 2001.

International Trade and Capital.

During 2001, Ukraine enjoyed a favorable balance of payments situation. During the first 10 months of the year, Ukraine's foreign trade in goods grew by 13.9% year-to-year to $26 billion, with its surplus in its trade in commodities reaching $728 million. Over this January-October period, exports increased by 14.6% year-to-year to $13.5 billion, while imports increased by 13.2% year-to-year to $12.8 billion. Ukraine's current account also showed a surplus of $1.1 billion during the first nine months of the year.

Over the year, however, the trade position of Ukraine gradually deteriorated as a result of the slow down on the world economy, the trade sanctions imposed on Ukraine's goods, the appreciation of the Hryvnia, and the decision by Russia to impose a 20% value-added tax on Ukrainian exports as of July 2001. For 2002, although Ukraine would continue to have a reasonable balance-of-payment position, it is unlikely that the trade surpluses achieved in 2000 and 2001 will be achieved.

Ukraine's trading partners have continued to increase and diversify, with the country now trading with over 190 countries. Although the share of Russia in Ukrainian exports has been reduced dramatically, it still accounts for 23% of Ukraine's overall exports. Other key trading partners include Turkey – 6.1% of exports, Germany – 4.3%, China – 3.6%, the USA – 3.7%, and Poland – 3%. Imports from Russia into Ukraine accounted for 37.3% of the total, from Turkmenistan – 10.2%, from Germany – 8.5%, from Kazakhstan – 4.5%, and from Belarus, the USA, and Poland – 2.8% each.

International Programs.

The International Monetary Fund postponed the expected January 9 consideration by its Board of Directors to disburse the next $375 million loan tranche to Ukraine. This postponement was due principally to the failure by the Government to make value-added tax reimbursements to exporters. As noted earlier, about UAH 5.7 billion in VAT refunds to enterprises are due, out of which UAH 1.9 billion are overdue. The IMF has required that a solution of this problem should have been made in connection with the approved budget for 2002. The initial draft fiscal budget for 2002 submitted to Parliament by the Government provided for resolving the VAT refund issue through partial cancellation and restructuring of the debt. But this provision was removed from the draft budget law with the expectation of issuing another law to address this problem. Other disbursement conditions set by the IMF included the adoption of a realistic 2002 fiscal budget, the completion of the audit of Naftogaz Ukrainy, increases in electricity tariffs, and strengthening of the supervision of commercial banks.

Given its level of reserves, Ukraine is no longer dependent of these IMF resources to maintain financial stability. But the renewal of IMF operations will become increasingly important as the balance of payment situation deteriorates during the course of 2002. The Government has stated that it will resolve this matter in the next few weeks.

Confirming the better economic outlook of Ukraine at present, Standard & Poor gave a single B rating to Ukraine's short and long-term local and foreign Government debt, with a Stable Outlook. Ukraine's short-term debt is now rated similarly to that of Russia.