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Ukraine - Economic Situation
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Economic Growth.

For a second consecutive year, in 2001 Ukraine's GDP showed a positive rate of growth. GDP grew by 9% during 2001, one of the highest rates of growth in a world plagued by recessions elsewhere. In dollar terms, in 2001 GDP reached about $39 billion or about $790 per capita, compared to $640 per capita in 2000. The high GDP growth was reflected in a 19% real increase in average wages for the year.

The 2001 high rate of GDP growth was driven principally by increases in value added in wholesale and retail trade (23.9%), processing industry (17.2%), agriculture (10%), and construction (7.6%). In terms of industrial sector composition, during 2001 the share of processing industries increased to 72.3% of total industry (compared to 70.4% in 2000). During the year, the fastest growing processing industries were oil refining and coke (which increased by 54.3%), wood and wood processing (28%), machine building (18.8%), pulp and paper (18.2%), food industry (18.2%), and textiles/apparel (14%). In terms of steel output, in 2001 Ukraine increased steel production by 5.5% to 33.5 million tons of steel, retaining the 7th place among 63 main steel-producing countries. The country exported 28.7 million tons of steel or about 87% of total production.

During the next few years, Ukraine intends to reduce steel production capacity by 5 million tons to 30 million tons, in line with the OECD initiative. The decision followed a sharp decline in world steel prices, caused by excessive metal supply at the world markets.

In January 2002, real GDP continued to grow though at a lower pace of 3.2% compared to the same month last year. This slowdown in economic growth in January 2002 (from 9.1% y/y growth in January 2001) reflected a low growth of industrial production, which was only 1.7% y/y in January 2002, compared to 19.5% y/y in January 2001.

For the entire year 2002, as reported last month, GDP is forecast to grow by 3 - 5% pa. The government projects a 6% GDP growth rate as the basis for its fiscal budget for 2002. This forecast may be difficult to achieve due to 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.

Fiscal Policies.

In 2001 the consolidated fiscal budget showed a small fiscal deficit of UAH 961 million ($185 million), which represented only 0.5% of the GDP for the year. Consolidated budget revenues and expenditures in 2001 amounted to UAH 54 billion ($10 billion) and UAH 55 billion ($10.2 billion), respectively, or about 26% of GDP. Consolidated budget revenues were UAH 3.3 billion short of the target for 2001. This was due to a UAH 3.6 billion shortfall in privatization proceeds. In fact, due to the failure to privatize the state telecom Ukrtelekom company and electricity distribution companies, the State Property Fund was able to transfer to the state budget about UAH 2.3 billion of revenues, compared to the initial target of UAH 5.9 billion.

In 2002, in accordance with agreements with the IMF, the planned fiscal budget deficit is UAH 4.3 billion or 1.7% of the 2002 GDP. For the year, the state budget envisages privatization receipts in amount of UAH 5.8 billion. These receipts, however, are not included in the budget as revenues, in accordance with the requirements of the IMF. They are included in the budget as a deficit-financing item. In the second half of 2002, the government intends to hold privatization tenders to sell 12 electricity-distributing companies following the recent removal of the President's ban on selling power companies. The resumption of privatization of electricity companies is an important condition for next IMF EFF tranche release.

Monetary Policies.

In 2001, monetary policies were expansionary, with monetary aggregates growing at rates exceeding the official initial forecasts. Money supply (M3) increased by 42% during 2001 and by 9.8% during December 2001. These increases in money supply, however, were not reflected in high inflation rates due to increases in money demand associated with high economic growth. This reflected revived public confidence in the national currency, which appreciated against US dollar by 2.5%.

In January 2002, money supply (M3) actually decreased by 4.3% compared to the previous month. The target increase in money supply, set by the NBU for 2002, is about 18-20%.

In 2001 the Consumer Price Index increased by 6.1% pa (compared to an initial 12.3% official forecast for 2001 and an inflation rate of 25.8% for 2000). In 2001, prices for foodstuffs increased by 7.9%, due to significant increase of prices for meat and oil, and despite the decline in prices for bread and cereals associated with a good harvest. Prices of services grew by 5.3%.. Prices of non-foodstuff items remained unchanged.

During January 2002, the CPI increased by 1%. For the entire year 2002, the IMF forecasts an annual inflation rate of about 10%, in line with the Government estimates of 9.8%. To achieve this target, the Government is aware that the rate of expansion of money supply should be checked and not exceed the target rate to 18-20% during 2002. With a lower rate of GDP growth forecast for 2002, money demand is unlikely to expand at a pace needed to absorb larger increases in money supply.

During 2001, the exchange rate for the Hryvnia appreciated by 2.5% to 5.3 UAH/$ by the end of December. This appreciation took place in spite that the NBU bought about $2.0 billion of foreign exchange in the inter-bank market to replenish its foreign exchange reserves. For 2002, the NBU forecasts a 5% annual depreciation of the Hryvnia.

At the end of the year 2001, the level of gross foreign exchange reserves reached a record $3.2 billion. During 2002, international reserves are not likely to increase substantially, due to poor export growth prospects. In fact, by the beginning of

February, gross international reserves had dropped to $3.1 billion. Provided that the IMF and World Bank lending program proceed as planned during 2002, the level of reserves should go up to $3.5 billion by the end of the year.

Government Debt.

During 2001 the foreign debt of Ukraine has been relatively stable at around $9.8 billion ($7.9 billion owed by the Ministry of Finance and $1.9 billion owed by the NBU to the IMF). Ukrainian external debt decreased somewhat as a result of repayment of $120 million to foreign governments, including country-members of Paris Club, $22 million to foreign commercial banks and $145 million on Eurobonds. On the other hand, during the period, Ukraine increased its borrowings by $200 million from the International Financial Institutions, namely the World Bank and EBRD.

International Trade and Capital.

In 2001 Ukraine trade balance in goods was positive, with a surplus of $490 million in 2001 (compared to a surplus of $616 million in 2000.) The reduction in the merchandise trade surplus in 2001 was caused by a deterioration of metal exports, which is the country's main export commodity, as well as the world's economy slowdown, which contributed to the lower external demand on Ukraine's exports in the last months of 2001. Antidumping investigations and trade sanctions also played a role. Preliminary data shows that in 2001 the Current Account had a surplus of about $600 million, compared to a surplus of $1.5 billion in 2000.

In 2001, exports of goods increased by 11.6% to $16.3 billion, while imports expanded by 13% to $15.8 billion. Ukraine main export markets were Russia (22.6% of total exports), Turkey (6.2%), and Italy (5.1%). Ukraine main import suppliers were Russia (36.9% of total imports), Turkmenistan (10.5%) and Germany (8.7%). The largest share of export products was represented by ferrous metals (30.6% of total exports), mineral products (10.8%), and chemical industry products (9.1%). The main imported goods were natural gas (20.8% of total imports), oil (13.35%), and machinery and equipment (10.5%).

For 2002, the Government anticipates that the trade surplus will be reduced further to $40 million. However, better export revenues from Services are expected to maintain the Current Account surplus to about $800 million for 2002.

In spite of good macroeconomic performance, Foreign Direct Investments (FDI) in Ukraine have remained depressed. In 2001, net FDI amounted to $531 million, down 10% from the level of $584 million achieved in 2000. In 2001, inflows of FDI into Ukraine amounted to $814 million, while outflows reached $283 million. As of January 1, 2002, the total stock of FDI in the country stood at $4.4 billion. The major foreign investors were the USA (with FDI of $731 million or 16.6% of the total), Cyprus (with $478 million or 10.8% of total), and the UK (with $420 million or 9.5% of the total). The sectors that received most of the FDI were food and processing industries (attracting $796 million or 18.1% of total), wholesale trade ($648 million or 14.7%), and financial sector operations ($361 million or 8.2% of FDI)).

International Programs.

As reported earlier, in January 2002, the IMF decided to postpone its Board consideration on the resumption of $370 million of disbursements originally expected for December 31, 2001 under the EFF Program. The main reason for the postponement was the failure by Ukraine to refund arrears on Valued Added Taxes VAT) owed to exporters. The IMF believes that VAT arrears discourage exports by enterprises. Nevertheless, IMF disbursements have become less critical for Ukraine for two reasons. First, the level of loan repayments to the IMF have declined substantially from $800 million due and paid in 2000, to $450 million due and paid in 2001, and only $230 million due in 2002. Second, this level of loan repayments due in 2002 to the IMF can be easily handled by the Government, given its high level of international reserves. The Government however is keen to renew the EFF program and has taken some measures to repay VAT arrears. They include allowing exporters to pay for electricity and gas with the VAT debt, and granting promissory notes that would allow companies with VAT arrears to enjoy a 30-day delay of payment of VAT on imported goods. These measures, however, were not considered sufficient by the IMF mission that left Kiev on February 11. Most likely, further negotiations on IMF disbursements will take place only after the March 31 Parliamentary elections.

The World Bank is considering granting Ukraine a second Programmatic Adjustment Loan for $250 million. This balance-of-payments loan is conditional on the removal by Ukraine of institutional bottlenecks that delay economic reforms. In particular, Ukraine will have to show progress on energy sector restructuring and privatization, improve fiscal discipline and budget execution, secure better property rights protection and continue social reforms. The program is under negotiations and is expected to be finalised only after September 2002.

On bilateral debt, by late March 2002, the Government expects to sign bilateral agreements for the restructuring of $580 million bilateral debt with the main country-members of the Paris Club (France, Germany, Italy, Japan and the US).