

## **Ukraine: good results on several fronts**

The Ukrainian economy grew by 7.3% in January-May 2003. This represents a remarkable improvement over the 4.8% recorded in 2002 as a whole. Demand in 2003 has been boosted by a strong pickup in investment, including construction, a revival of exports to Russia, by ongoing strong rises in real wages and money incomes, and by growth in transport services. In January-March 2003, both consumer- and, especially, producer-price inflation were more rapid than during the same period of 2002, but the rises appear benignly 'Keynesian', and remain well below Russia's. The currency has followed the dollar down, boosting export prospects, *cet. par.*, in the eurozone. Having met a large set of payments in March, the government in June easily raised USD 800 million worth in ten-year notes at 7.75%, despite the absence of an IMF agreement, as the debt-to-GDP ratio remains modest.

Industrial growth also accelerated in the first months of 2003. In the first five months of the year, measured value added in the construction sector was up 17.5% year on year; sales of electricity, gas and water rose 11.5%. Manufacturing, which accounts for over three-quarters of industrial production, grew an impressive 12.8%. This was both an acceleration on first-quarter figures and more than twice the rate recorded in January-May 2002. Within industry, in the first four months many of the usual suspects again outperformed: the food industry gained 15.9%, sales of forest products were up 20.4%, ferrous and non-ferrous metals were up 14% after a weak 2002, machine tools rose 21.1%, and certain chemicals also did well. Output of petroleum products was flat, however, after strong growth in 2002. Agricultural production stagnated in the first four months, and frosts have been blamed for major losses of winter crops, so a poor harvest and food price rises are forecast; state bodies are threatening to restrict exports in consequence. The reform-minded former deputy prime minister for agriculture has been arrested on corruption charges in connection with state-mediated exports of the 2002 bumper grain crop, to a chorus of western protests.

Budget revenues were about on target in the first quarter, even allowing a slight surplus, though VAT and other tax arrears persist. On the planned outlay side, wage, salary and VAT refund arrears remain problematic. In the energy sphere, about a quarter of gas remains unpaid for, affecting tax collections from the sector; still, prices charged have been raised much closer to world levels than in Russia. FATF (Financial Action Task Force) anti-money laundering sanctions have been called off.

Real wages and incomes continue to rise strongly. A flat income tax similar to Russia's is due to be levied beginning in January 2004, designed to increase revenue by widening the

base and removing exemptions (shrinking the shadow economy). If this fails, it may prove difficult for the government to fund election-year planned increases in minimum wages and pensions without boosting inflation. Demographic data point to severe poverty and unemployment. Between 2 and 7 million citizens may be working illegally abroad, many on a seasonal basis, an outlet threatened by plans to tighten visa regimes in accession countries like Poland. Some 11% of the labour force is unemployed on ILO definitions. In Transcarpathia nearly half the population is below the poverty line, notwithstanding several years' rapid growth in the forest products sector. The UN projects that population will drop by a third by 2050.

Ukraine's international standing has moved out of the basement thanks to opportunities afforded by the Iraq conflict. Ukraine gained favour with the US by contributing specialist personnel both during and after the hostilities. The Kolchuga radar system, whose illegal sale to the Iraqis was allegedly approved by President Kuchma, has not been found; at any rate it was not blamed for losses of coalition air personnel.

Exports and trade generally benefited from the dollar's decline and Russia's oil-inflated current account surplus. The dollar value of exports surged 25% in the first quarter. Imports rose 27.4%, even as the trade balance remained strongly positive. Exports to Russia rose over a quarter, after falling in 2002. Measured in euros, goods exports to all destinations in the first quarter also managed a 4.3% rise on an annual basis; this effect should be more pronounced in the second quarter.

For internal reasons, and owing to Ukraine's weak record on reforms, EU enlargement officials have stopped dangling the carrot of possible future membership to the Kuchma government. Ukraine, Belarus and Moldova are presently in a less-favoured group than e.g. Albania or Serbia-Montenegro, or indeed, Turkey; the relationship suggested for Ukraine as of mid-2003 is similar to those offered North African and other African countries: no talk of eventual membership, but closer economic integration and enhanced political cooperation in exchange for political, economic and institutional reform, based on 'shared values'. An important incentive remains, however, the prospect of visa-free travel. The current PCA (Partnership and Cooperation Agreement) with the EU does not include significant preferential trade provisions, and has been poorly implemented in any event. Ukraine is therefore concentrating on its WTO negotiations, and may qualify in 2004. However Russia is pushing Ukraine to coordinate WTO concessions, and indeed the deal on the Odessa-Brody pipeline, with it. Timely creation of a 'common economic space' with Russia et al., to involve free trade, common external tariffs and adoption of the rouble, seems fanciful.

The pre-election season is beginning. Presidential elections are scheduled for the autumn of 2004, and according to the constitution, incumbents are not eligible for a third term.

There are rumours that President Kuchma may try to retain power and immunity from future corruption charges by engineering a change in the constitution to create an upper chamber of regions, where e.g. he might stay on as 'queen' or 'first senator for life'. Ex-Prime Minister Yushchenko remains the favourite to win the presidency under the current rules. One strategy which might spare President Kuchma the fate of e.g. his ex-Prime Minister Lazarenko, currently being prosecuted for money laundering and embezzlement in several countries, would be to hand-pick a successor such as, for example, Prime Minister Yanukovych. At present it seems likely that e.g. Yushchenko would defeat Yanukovych, but it is too early to say whether Kuchma will manage to wangle an honorary position for his retirement years – fences with both Russia and western countries are being mended, the economy is improving, Russia still has oil money to spend, and 16 months are a long time in politics.

Table UA

## Ukraine: Selected Economic Indicators

	1998	1999	2000	2001	2002 <sup>1)</sup>	2002 1st quarter	2003	2003 forecast	2004
Population, th pers., end of period <sup>2)</sup>	50105.6	49710.8	49291.2	48415.5	48003.5	.	47879.4	47650	47350
Gross domestic product, UAH mn, nom.	102593	130442	170070	204190	220932	43699	48346	257500	286500
annual change in % (real)	-1.9	-0.2	5.9	9.2	4.8	4.1	7.0	6	4
GDP/capita (USD at exchange rate)	833	633	632	781	860	.	.	965	1045
GDP/capita (USD at PPP - wiiw)	3630	3710	4040	4600	4920	.	.	.	.
Gross industrial production									
annual change in % (real)	-1.0	4.0	12.4	14.2	7.0	5.9	10.7	9.0	7.0
Gross agricultural production									
annual change in % (real)	-9.6	-6.9	9.8	10.2	1.9	11.1	1.3	0	5
Goods transport, bn t-kms	391.7	388.0	394.1	393.8	.	.	.	.	.
annual change in %	-2.6	-0.9	1.6	-0.1	3.3	3.0	10.0	.	.
Gross fixed investment, UAH mn, nom.	13958.0	17552.0	23629.0	32573.0	37178.0	4804.8	.	.	.
annual change in % (real)	6.1	0.4	14.4	20.8	8.9	9.6	23.1	10	15
Construction output total									
annual change in % (real)	2.7	-8.0	9.1	16.7	-0.7	-5.0	.	.	.
Dwellings completed, units	70000	73000	62600	65000	.	.	.	.	.
annual change in %	-12.5	4.3	-14.2	3.8	3.2	4.6	-17	.	.
Employment total, th pers., average	22348.7	21823.7	21268.5	20941.9	20100	.	.	20000	.
annual change in %	-1.1	-2.3	-2.5	-1.5	.	.	.	.	.
Employees in industry, th pers., average <sup>3)</sup>	4142.0	3932.0	3445.0	3806.0	.	.	.	.	.
annual change in %	-3.1	-5.1	-12.4	-6.1	.	.	.	.	.
Reg. unemployed, th pers., end of period	1003.2	1174.5	1155.2	1008.1	1034.2	1079.2	1109.4	.	.
Reg. unemployment rate in %, end of period	3.7	4.3	4.2	3.7	3.8	3.9	4.0	4	4
LFS - unemployment rate in %, average	11.3	11.9	11.7	11.1	10.2	10.6	.	11	11
Average gross monthly wages, UAH <sup>3)</sup>	153.0	177.5	230.1	311.1	376.4	334.8	402.4	.	.
annual change in % (real, gross)	-3.2	-5.4	1.1	20.7	20.0	21.3	17.6	.	.
Retail trade turnover, UAH mn	19317	22151	28757	34417	39192	8206.6	9895.2	.	.
annual change in % (real)	-6.6	-7.1	8.1	13.7	14.8	16.8	12.4	.	.
Consumer prices, % p.a.	10.6	22.7	28.2	12.0	0.8	3.7	2.2	10	7
Producer prices in industry, % p.a.	13.2	31.1	20.9	8.6	3.1	-0.3	7.8	5	0
General government budget, UAH mn									
Revenues	28915.8	32876.4	49117.9	54934.6	60812.1	12689.0	15375.8	50021 <sup>4)</sup>	.
Expenditures	31195.7	34820.9	48148.6	55528.0	59085.2	12028.4	13504.5	52056 <sup>4)</sup>	.
Deficit (-) / surplus (+)	-2279.9	-1944.5	969.3	-593.4	1726.9	660.6	1871.3	-2035 <sup>4)</sup>	.
Deficit (-) / surplus (+), % GDP	-2.2	-1.5	0.6	-0.3	0.8	1.5	3.9	-0.83 <sup>4)</sup>	.
Money supply, UAH mn, end of period									
M0, Currency outside banks	7158	9583	12799	19465	26434	19646	26000	.	.
Broad money	15718	22070	32084	45555	64532	47345	69731	.	.
Refinancing rate of NB % p.a., end of period	74.2	45.0	27.0	12.5	7.0	11.5	7.0	.	.
Current account, USD mn	-1296	1658	1481	1402	3173	827	1082	1800	.
Current account in % of GDP	-3.1	5.2	4.7	3.7	7.7	10.1	11.9	4.0	.
Gross reserves of NB excl. gold, USD mn <sup>5)</sup>	761	1046	1352	2955	4241	2962.3	4447.8	4500	.
Gross external debt, USD mn	11483	12438	10350	12100	10200	.	.	10563	11000
Exports total, fob, EUR mn <sup>6)</sup>	11283	10856	15771	18159	19004	4419	4607	20200	21400
annual change in %	-10.1	-3.8	45.3	15.1	4.7	7.4	4.3	6	6
Imports total, cif, EUR mn <sup>6)</sup>	13103	11104	15104	17612	17967	4047	4225	18700	19800
annual change in %	-13.2	-15.3	36.0	16.6	2.0	5.0	4.4	4	6
Average exchange rate UAH/USD	2.450	4.130	5.440	5.372	5.327	5.319	5.334	5.7	5.8
Average exchange rate UAH/EUR (ECU)	2.768	4.393	5.029	4.814	5.030	4.662	5.718	6.3	6.4
Purchasing power parity UAH/USD, wiiw	0.561	0.705	0.850	0.913	0.932	.	.	.	.
Purchasing power parity UAH/EUR, wiiw	0.611	0.768	0.931	1.000	1.008	.	.	.	.

Notes: 1) Preliminary. - 2) In 2001 according to census 5 Dec 2001. - 3) Excluding small enterprises. - 4) Budget passed by Parliament end December 2002. - 5) Useable. - 6) Exports and imports of goods according to customs statistics, adjusted for oil, gas and non-declarable goods. Converted from USD to EUR using the ECB EUR/USD foreign exchange reference rate.

Source: wiiw Database incorporating national statistics; wiiw forecasts.