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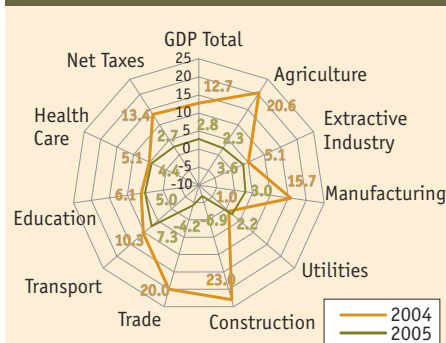
Summary

- In October, Ukrainian economic growth reported a 2.2% year-over-year (yoy) increase; however, cumulative growth remained unchanged at 2.8% yoy.
- In January-September, the consolidated budget registered a surplus of 2% of GDP. Amendments to the 2005 State Budget, adopted in November, envisage an increase in the fiscal deficit from 1.6% of GDP to 2.3% of GDP. Considering the fact that the budget is currently in surplus, this will result in considerable fiscal loosening at the end of the year.
- Consumer price inflation continued to decelerate to 12.4% yoy in October; despite considerable inflationary pressure caused by high fuel prices, significant capital inflow and social payments, year-end inflation will be below last year's.
- Despite a worsening merchandise trade balance, Ukraine's current account will be in surplus thanks to a strong external position in trade of services.
- At the beginning of December, the European Commission officially announced its decision to grant market economy status to Ukraine.

Economic Growth

After sharp deceleration during January-August, primarily caused by a sharp downturn in both domestic and foreign investments and declining world demand for metals, cumulative economic growth remained stable at 2.8% yoy over the next two months. In October, GDP reported a 2.2% yoy increase, slightly lower than expected considering the relatively low base period and the 3% yoy at which economic growth rebounded in September. According to the latest statements from government officials, GDP growth is expected to reach 3.8% yoy in 2005. This is more than three times lower than the growth achieved last year. However, even this modest figure may turn out to be optimistic, given the continuing slowdown in industry and the decline in domestic trade and construction.

GDP Growth by Sector in January-October, % yoy



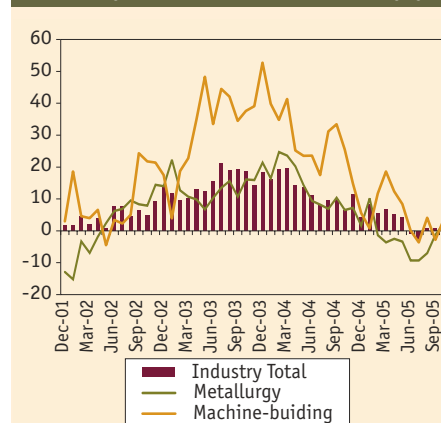
Source: State Statistics Committee

Despite a fairly good harvest this year, value added growth in agriculture decelerated to 2.3% yoy over January-October, which should be attributed to a high base effect. Over the period, deceleration in domestic trade and construction continued. Value added in domestic trade declined by 4.2% yoy over January-October,

the same rate as in the previous period. Contraction in the sector was mainly due to wholesale trade rather than retail. The latter, benefiting from the population's growing real income, continued to increase. At the same time, deterioration of wholesale trade may be attributed to a high base effect, de-shadowing of trade and sluggish investment activity. Value added in the construction sector continued to decelerate over the period, registering 6.9% yoy, down from 7.2% yoy over January-September. On the upside, transport (which accounts for about 12% of total value added and which expanded by 7.3% yoy) became the main contributor to period GDP growth.

Industrial output continued to decelerate over January-October, reporting 3.1% yoy growth, almost unchanged from the 3.2% yoy reported in the previous period. During October, industrial output growth accelerated to 2.4% yoy, up from 0.9% yoy in September. The acceleration occurred thanks to a growth rebound in metallurgy and machine-building. For the first time since February of this year, metallurgy reported growth of 2.3% yoy, which may be attributed to stabilization of world steel prices. As a result, the cumulative reduction of metallurgical output slowed to 2.4% yoy. Although machine-building production rebounded to 3.4% yoy in October (after a drop in production by 2.8% yoy a month before), cumulatively it continued to decelerate. On the upside, the growth of output in food processing remained virtually unchanged at a high 14.4% yoy. Benefiting from high external demand, chemicals demonstrated a healthy 10.2% yoy increase over January-October.

Industry Growth - Selected Sectors, % yoy



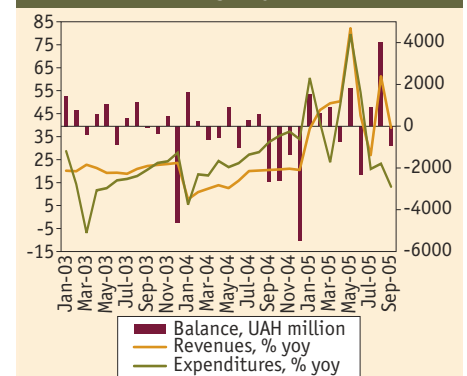
Source: State Statistics Committee

Fiscal Policy

Although economic growth slowed considerably this year, fiscal budget performance has so far been successful. According to preliminary data released by the State Treasury of Ukraine, the consolidated budget surplus reached UAH 5.8 billion (about \$1.15 billion) over January-September, which is equivalent to 2% of period GDP. Consolidated budget revenues went up by a nominal 39% yoy to reach UAH 95.1 billion (\$18.8 billion), while expenditures grew by a more

moderate 13% yoy to UAH 89.3 billion (\$17.7 billion). A fiscal surplus was achieved thanks to a considerable increase in tax proceeds and under-fulfillment of expenditures, except social transfers. The growth of tax revenues may be due to improved tax compliance, as well as advanced payments of enterprise profit tax and accumulation of VAT refund arrears.

Consolidated Budget Dynamics, 2003-05



Source: Ministry of Finance

On November 3rd, the Parliament adopted amendments to the 2005 State Budget, which were signed by the President a few days later. The state budget revenues were lowered to UAH 106.1 billion (\$21 billion), down by 0.6%, at the expense of non-tax revenues, while expenditures were increased by only 1.1% to UAH 115.8 billion (\$22.9 billion). In particular, the government decided to allocate an extra UAH 2.8 billion (\$554 million) for financing the shortage of pension fund resources and UAH 0.5 billion (about \$100 million) as subsidies to local budgets for paying budget sector employees' wages and utility bills. As a result of these changes, the state budget deficit widened to UAH 9.53 billion, or 2.3% of forecasted full-year GDP (up from the previous 1.6% of GDP). Considering that budget is currently in surplus, the amended budget parameters envisage considerable fiscal loosening in the last two months of the year. However, due to last year's sizable pre-election fiscal expansion, this may not jeopardize the declining trend of the consumer price index at the end of this year and the beginning of next year.

To ensure budget gap financing, the parliament increased targeted privatization receipts to UAH 8.6 billion (\$1.7 billion). Taking into account the successful privatization of Kryvorizhstal for a record high \$4.8 billion, this target is not casting any doubts. However, because of the considerable social liabilities taken during 2004-2005 and the further increases foreseen in pensions and minimum wages in 2006, and acknowledging that one-shot privatization revenues aren't reliable source of fiscal gap financing in the long-term, the government will need to undertake significant efforts to balance the budget in the medium-term.

At the beginning of November, the parliament endorsed the draft fiscal budget for 2006 as a basis for further consideration and sent it back to the government for revision. The amended draft budget law envisaged an in-

Macroeconomic Situation

crease in the targeted budget deficit for 2006 to UAH 12.9 billion (\$2.6 billion), or 2.5% of GDP. More than 85% of next year's deficit is planned to be financed by privatization receipts. In particular, the government expects to obtain UAH 2.1 billion from new privatization deals next year, while the rest will be covered by the funds received from privatization of Kryvorizhstal. The privatization receipts target may be realistic as key state officials have already announced the intention to privatize a number of attractive enterprises next year, like telecommunication monopoly "Ukrtelecom," Nikopol ferroalloy plant and Odessa port plant.

Over January-October, the stock of public debt increased by 1.3% yoy to \$16.3 billion. By structure, the increase was actually observed for external debt, which picked up to almost \$12 billion, while internal debt continued to decrease. The increase in external debt was primarily the result of Eurobonds placements. In contrast to public debt, the rapid increase in external private debt raises concerns. According to NBU statistics, since 2004 external medium and long-term private debt has increased 2.3 times to \$8.2 billion as of mid-2005 and continues to grow. So far, the NBU and the government are examining measures to tighten eligibility criteria for enterprises desiring to borrow on external markets.

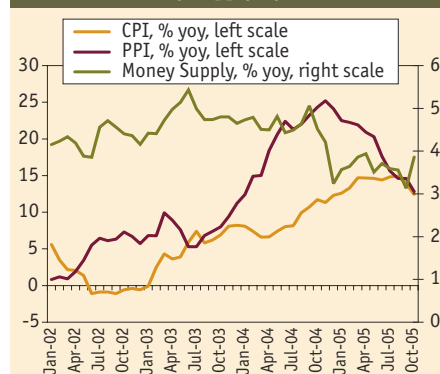
Monetary Policy

In October, the monthly consumer price index (CPI) accelerated slightly to 0.9% month-over-month (mom) on the back of seasonal increases in food prices. Consumer inflation continued to decline in annual terms, reporting a 12.4% yoy increase, down from 13.9% yoy in the previous month (which is partially explained by high comparison base.) Over the month, food prices grew by 13.6% yoy, which is a considerable deceleration compared to 16% yoy a month ago. The slowdown occurred primarily due to decelerating prices for meat, sugar and milk. For the first time since 2003, meat prices declined by 0.6% mom; the reduction may be attributed to lower demand for meat products, especially chicken, affected by the "bird flu" concerns. Following the stabilization of world prices, domestic gasoline prices dropped 0.3% mom. As result, the annualized non-food price index returned to a declining trend, reporting a 5.1% yoy increase in October, down from 5.2% yoy in September. However, the surge in gasoline prices in previous months stimulated a further increase in transportation tariffs, which accelerated to 26.1% yoy, up from 23.7% yoy in September. On account of a further increase in transportation tariffs and the cost of public utilities (up by 14% yoy in October versus 13.2% yoy a month before), the services index accelerated to 14.4% yoy, up from 13.5% yoy in September. In October, the producer price index (PPI) decelerated to 12.8% yoy, down from 14.6% yoy in September.

According to estimates by the Council of the National Bank of Ukraine (NBU) announced in mid-November, consumer inflation is expected in the range of

10.5%-12% yoy in 2005, which is quite realistic. In addition to high fuel prices and increasing utility costs, the price developments through the end of the year will be affected by inflationary amendments to the 2005 budget and considerable social payouts at the end of the year. At the end of November, the privatization auction-winner Mittal Steel transferred the entire amount for the purchase of Kryvorizhstal. The NBU quickly converted the amount into hryvnia at an exchange rate of UAH/\$ 5.0, thus replenishing its reserves to \$19 billion. Thanks to quick NBU measures, concerns regarding foreign exchange stability did not materialize.

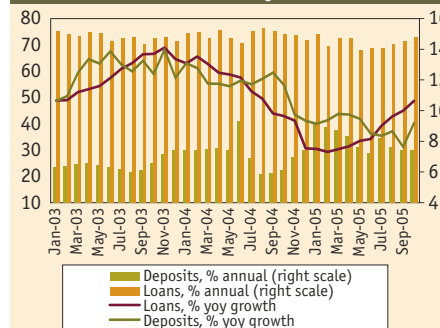
Prices and Money Supply Dynamics, 2001-05



Source: State Statistics Committee, National Bank of Ukraine

Large social payouts from the budget as well as capital inflow related to privatization and future parliamentary elections are causing significant upward pressure on monetary aggregates. Already in October, the monetary base accelerated to 34.6% yoy from 27.2% yoy in September, while the money supply accelerated to 38.6% yoy, up from 31.3% yoy. Observing current monetary aggregates developments, the Council of the NBU increased its forecast for monetary base growth in 2005 to 50-55% yoy (up from the previous 38-43% yoy), while the money supply growth forecast was raised to 48-53% yoy (up from 40-45% yoy).

Loans and Deposits Growth and Interest Rate Dynamics



Source: National Bank of Ukraine

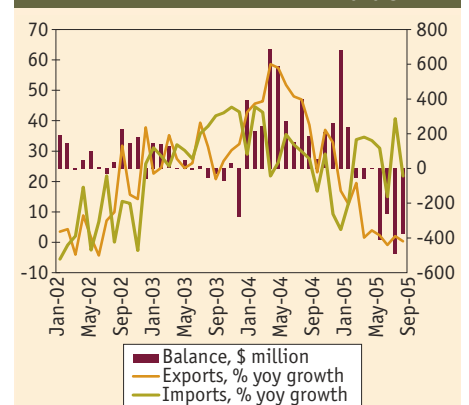
Acceleration of deposits growth to 40.3% yoy and currency in circulation by 33% yoy contributed to the expansion of money supply. Rapid growth of deposits

on the back of the unchanged deposit rate (which is much lower than the annual inflation rate for that period) may be explained by the low base for comparison. Last year, inflationary expectations and political uncertainty led to massive withdrawals of deposits from commercial banks. October reported further acceleration of private sector credit expansion to 48.7% yoy, up from 45% yoy a month before. As the rapid increase in domestic credit raises concerns regarding the quality of banks' credit portfolios, the NBU decided to toughen requirements regarding minimum regulatory capital. Commercial banks will have to adjust their capital to the new regulation by the end of next year.

International Trade and Capital

Over January-September, Ukraine's merchandise foreign trade balance continued to worsen. Weaker external demand for Ukrainian metals, the main export commodity, reinforced by sharp national currency appreciation in April, resulted in a quick deceleration of exports over April-September. The pace of export expansion dropped from a healthy 19.5% yoy in March to a miserable 0.3% yoy in September. On the other hand, imports growth accelerated from 9.2% yoy in January to almost 40.5% yoy in August. In September, imports growth decelerated to 22% yoy; however it still considerably outpaced that of exports. Cumulatively, FOB exports grew by 6% yoy (versus almost 46% yoy growth in January-September last year) to \$22.3 billion, while CIF imports expanded by 26% yoy to \$26 billion.

Merchandise Trade Performance, % yoy growth



Source: State Statistics Committee

By product breakdown, exports of metallurgical products rebounded at almost 1% yoy in September following two months of decline. In cumulative terms however, cross border metals sales continued to slow, reporting a 14% yoy increase over January-September versus 16% yoy over January-August. Considering the fact that world prices returned to an upward trend in September, metals export performance may improve through the end of the year. A rebound in machinery and equipment exports at 3.6% yoy in September, after an almost 30% yoy de-

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cline in April and May and another 10% yoy decline in July, is encouraging. Cumulatively, export volumes of these products declined by 11.5% yoy. On the import side, deceleration of machines and transport equipment imports and oil and gas imports, the largest contributors to total imports, explains the total goods import slowdown in September. In particular, imports of machinery and equipment increased by about 34.7% yoy over January-September, down from 37.6% yoy in January-August. Imports of energy resources, the weightiest item in total goods imports, decelerated to 9.5% yoy over January-September, down from 10.4% yoy a period ago.

At the same time, Ukraine's foreign trade of services position remained rather strong according to the State Statistics Committee. Over January-September, exports of services increased by 11.6% yoy to \$4.3 billion, while imports grew by 33.3% yoy to \$1.9 billion. As a result, a surplus of \$2.4 billion was registered, just 1.5% yoy lower than in the corresponding period last year. Despite shrinking by almost 70% yoy, the foreign trade of goods and services account showed a surplus of \$1.6 billion. Taking into account current foreign trade performance, the current account will remain in surplus through the end of the year.

Other Developments and Reforms Affecting the Investment Climate

At the beginning of December during the Ukraine-EU summit, the European Union declared Ukraine has fulfilled all requirements necessary to be recognized as a market economy. However, the status will formally be granted at the beginning of next year due to technicalities. The status will improve the treatment of Ukrainian exporters in anti-dumping investigations with EU members. Moreover, obtaining the status is an important step towards signing a free-trade agreement with the EU. It may also help in Ukrainian officials' efforts to simplify the EU visa requirements for Ukrainian citizens.

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