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# UKRAINIAN ECONOMIC OUTLOOK

tendencies

estimates

forecasts

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## List of Abbreviations

aop	average over period
CIS	Commonwealth of Independent States
CPI	consumer price index
eop	end of period
EU	European Union
FSTS	First Securities Trading System
GDP	Gross Domestic Product
NBU	National Bank of Ukraine
NEER	nominal effective exchange rate
PPI	producer price index
qoq	quarter over quarter
REER	real effective exchange rate
SEZ	special economic zone
TPD	territory of priority development
UAH	Ukrainian Hryvnia
VAT	value-added tax
WTO	World Trade Organization
yoy	year over year

## 1. Overview of Economic Development in 1Q07

In 1Q07 GDP resulted with 8.0% yoy in real terms, which is quite impressive comparing to the corresponding period of the previous year (+2.4% yoy in 1Q06). The performance was helped by a substantial increase in industrial production, as well as continued high paces of market services growth.

The beginning of 2007 is characterized by increasing role of net exports in GDP growth, and a decrease of domestic demand contribution. The contribution of net export is driven by positive real exports growth rates (+5.8% yoy in 1Q07 compared to -14.9% yoy in 1Q06).

Favourable external conditions for Ukrainian industry, as well as growing private consumption (though at lower rates than in 2006) defined the major trends of the 1Q07. Contrary to 2006, when primarily market services were driving GDP growth, this year manufacturing industries substantially expanded their output due to strong external and domestic demand, and outpaced services growth.

In the first quarter real disposable household income increased by 11.1% yoy in comparison with

corresponding period of the last year. That continued the trend of slacken the speed of growth, which started a year ago. Structure of nominal revenues remains constant and does not differ much from 1Q06 data with salaries and transfers representing major sources of income (45.8% and 42.2% correspondingly).

In 1Q07 CPI was growing at a quite moderate pace as compared to the end of 2006. During January-March consumer prices grew by 1.3% (2.7% during 1Q06). In contrast to the CPI trend producer prices were accelerating throughout 1Q07. PPI increased by 17.8% yoy by the end of 1Q07 (6.5% yoy a year ago). The increase was driven by price growth in the world markets of metal and chemicals that has transmitted to the Ukrainian market.

Despite further deterioration of the current account balance, inflow of foreign capital was more than sufficient to cover the demand for foreign exchange in 1Q07. Temporary surplus of foreign currency supply was bought out by the NBU that continued to maintain fixed exchange rate of UAH vs. USD at 5.05. All in all the Central bank bought USD 0.99 billion over 1Q07 (compared with – USD

Table 1.1 Selected indicators, change in %, 2003-2008

	2003	2004	2005	2006	2007(f)	2008 (f)
GDP (change in %)	9.6	12.1	2.6	7.1	6.9	6.3
Domestic demand	12.6	9.4	11.4	13.2	7.6	7.6
Private consumption	12.4	16.3	16.6	14.4	11.8	11.0
Gross capital accumulation	15.8	10.2	-0.3	18.6	12.7	9.4
Industry (value added, change in %)	13.6	10.4	2.0	4.8	7.8	7.1
Market services (value added, change in %)	15.8	13.9	-2.1	11.8	10.2	9.5
CPI (eop., %)	8.2	12.3	10.3	11.6	9.4	7.5
CPI (yoy, aop., %)	5.2	9.0	13.6	9.1	10.3	9.4
PPI (eop., %)	11.2	24.3	9.6	14.2	14.4	7.5
PPI (yoy, aop., %)	7.8	20.3	17.0	9.5	16.9	8.9
Money supply M3 (change in %, aop.)	47.9	44.9	38.6	39.2	31.9	28.3
Current account balance (% of GDP)	5.8	10.6	3.1	-1.5	-1.3	-1.4
Exchange rate (UAH/USD; eop.)	5.33	5.31	5.05	5.05	5.05	5.1
Budget deficit (% of GDP)	0.2	2.9	1.7	0.7	2.7	2.0

Source: State Statistics Committee of Ukraine, CASE Ukraine estimates



1.84 billion in 1Q06).

Nominal effective exchange rate (NEER) of UAH declined by 0.5% qoq, which resulted from devaluation versus EUR and RUR. Real effective exchange rate (REER) decreased by 1.3% qoq in 1Q07 (contrary to appreciation in 2H06). Continued depreciation of USD in the world markets and moderation of price growth are expected to force REER further down.

In order to reduce excessive banks' liquidity in the beginning of the year the NBU conducted massive operations to mobilize the banks' funds. During January 2007 the volume of mobilization operations amounted to UAH 6.6 billion which is approximately the same amount as during the whole 2006. All together in 1Q07 the NBU decreased the liquidity of the banking system by UAH 46.9 billion.

Over the 1Q07 deposits expanded by 6%, compared with 2.1% in 1Q06. Most of the increase was fueled by growth of deposits denominated in national currency. Solid deposit growth over 1Q07 was among the main factors behind 'wide' money supply growth intensification. M3 grew less significantly at 0.6% qoq.

During 1Q07 high demand for money has been expanding. Credits grew by 11.4% compared with +10% in 1Q06. Foreign currency denominated credits grew the fastest and their share in overall credit volumes exceeded 50%.

In 1Q07 the consolidated budget balance resulted with a surplus of 4.8% of GDP (USD 1.3 billion). This was ensured by successful fulfillment of the revenues plan and low level of spending. Continued stable fiscal stance translated into solid savings of the government. At the end of March 2007 the accumulations of the Ministry of Finance on treasury accounts went up to USD 4.3 billion (3.8% of yearly GDP).

Consolidated revenues grew slightly in 1Q07 and amounted to 33.3% of GDP (31.2% in 1Q06). The increase in inflow of VAT, enterprise profit tax

(EPT) and personal income tax (PIT) was underpinned by sustainable economic growth. Despite rapid growth of budget revenues most of expenditure components underwent reduction compared to the previous year. In 1Q07 budget spending constituted 28.4% of GDP (30.9% in 1Q06). Presumably, government adheres to usual strategy to accumulate resources by the end of the year when maximum outlays usually take place.

In 1Q07, merchandise exports from Ukraine (totaling USD 10.73 billion) grew a bit faster than imports (totaling USD 12.95 billions), i.e. at +33% yoy vs. +32.2% yoy respectively (-3.6% yoy vs. +30.7% yoy in 2006). Nevertheless, exports growth acceleration did not prevent deterioration of the merchandise trade balance: the merchandise trade deficit increased to USD 2.2 billion in 1Q07 compared to USD 1.7 billion in 1Q06.

Trade in services traditionally resulted with a surplus of USD 0.86 billion in 1Q07. Persistent upward trend of steel world prices boosted further expansion of metallurgical products nominal exports in 1Q07 (+ 40.9% yoy compared to -7.7% yoy in 1Q06). At the same time import increase has been much driven by energy material prices growth. Nominal energy resource imports went up by 27.9% providing for 32.6% of overall commodity import volumes in 1Q07.

According to the State Statistics Committee of Ukraine the inflow of foreign direct investment to Ukraine in the first quarter of 2007 equaled USD 1,331.7 million, including from CIS - USD 94.2 million (7.1%), and from the rest of the world - USD 1,237.5 million (92.9%). This would be more than 30% increase compared to the corresponding period of 2006, if not the record amount of withdrawals this quarter. The amount of capital withdrawn from Ukraine constituted USD 535.7 million, which is almost a five-time increase compared to the corresponding period of the year 2006.



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