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UKRAINIAN ECONOMIC OUTLOOK

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Project Manager/ Editor-in-Chief:

Dmytro Boyarchuk

Authors:

Dmytro Boyarchuk, Viachaslau Herasimovich,
Svitlana Taran, Anna Tsarenko

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CASE Ukraine

Center for Social and Economic Research

10 Starokyivska Str., Suite 107, Kyiv 04116, Ukraine

Tel./Fax: +380 (44) 2275317

E-mail: info@case-ukraine.kiev.ua

www.case-ukraine.com.ua



List of Abbreviations

aop	average over period
CIS	Commonwealth of Independent States
CPI	consumer price index
eop	end of period
EU	European Union
FDI	foreign direct investment
FSTS	First Securities Trading System
GDP	gross domestic product
NBU	National Bank of Ukraine
NEER	nominal effective exchange rate
PPI	producer price index
q/q	quarter over quarter
REER	real effective exchange rate
SSC	State Statistics Committee of Ukraine
UAH	Ukrainian Hryvnia
VAT	value-added tax
WTO	World Trade Organization
y/y	year over year

1. Overview of Economic Development in 3Q07

The third quarter 2007 of socio-economic life of Ukraine was marked with early parliamentary election campaign stemming from spring political crisis when president dissolved the V session of Verkhovna Rada. Apart from political turmoil the national economy underwent strong internal and external shocks. Specifically the current year poor harvest stimulated a wave of record high consumer inflation. International resource price tendencies also reflected on domestic prices dynamics. However, the strongest external effect was observed on FSTS index which dropped after mortgage crisis and liquidity crunch at the US. Even though the real sector proved to be resilient.

In autumn Russia initiated new talks around revision of imported gas price in line with growing prices of Asian gas. After long negotiations Fuel Ministry and Gazprom agreed on \$179.5 per thousand cubic meters for next year. At the same time Ukraine managed to increase price for transit of Russian gas. The producers do not expect significant effect of high energy costs on their performance.

Although GDP slowed down to 6.3% y/y after agri-production slump, the key sectors of economy (manufacturing and market services) were growing with more than 10% y/y. Private consumption led by growing income and booming crediting and invest-

ment demand underpinned the real sector growth. At the same time external demand was rather weak in real terms while in nominal values exporters were comfortable due to high resource prices.

In 3Q07 merchandise trade balance worsened to -5.9% of quarterly GDP. Both exports and imports were slowing down during the quarter. Exports decelerated thanks to ferrous metals and metal products, as well as chemicals. At the same time imports weakened due to reduction in energy imports volumes. Despite significant negative trade balance the foreign currency inflow was supported by the outstanding investment activity and considerable external borrowings of Ukrainian banks.

The NBU continued buying out currency at the market thus maintaining stable exchange rate of hryvnia (UAH 5.05 per \$1), feeding monetary aggregates expansion and accumulating monetary reserves. Through the quarter monetary base expanded by 15.0% q/q and broad money supply grew by 14.9% q/q. The gross reserves reached 5.2 months of imports (\$30.6 billion) by the end of September.

On the heel of US dollar devaluation the Central bank announced its intention to strengthen hryvnia vs. dollar. The step was supported by steady foreign currency inflow and significant accumulated reserves.

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	7.0	6.5
Domestic demand	12.8	8.6	15.2	13.0	12.4	11.5
Private consumption	11.5	13.1	20.6	14.4	16.2	13.7
Gross capital accumulation	22.5	20.5	3.9	18.6	22.2	16.9
Industry (value added, change in %)	13.1	9.6	0.8	4.8	9.0	5.8
Market services (value added, change in %)	16.0	12.4	-3.3	11.8	11.0	10.3
CPI (eop., %)	8.2	12.3	10.3	11.6	15.3	11.5
CPI (yoy, aop., %)	5.2	9.0	13.6	9.1	12.6	15.2
PPI (eop., %)	11.2	24.3	9.6	14.2	19.2	16.2
PPI (yoy, aop., %)	7.8	20.3	17.0	9.5	20.4	13.2
Money supply M3 (change in %, aop.)	47.9	44.9	38.6	39.2	42.6	31.1
Current account balance (% of GDP)	5.8	10.6	3.1	-1.5	-3.4	-4.6
Exchange rate (UAH/USD; eop.)	5.33	5.31	5.05	5.05	5.05	4.9
Budget deficit (% of GDP)	0.2	2.9	1.7	0.7	1.7	2.0

Source: State Statistics Committee of Ukraine, CASE Ukraine estimates



However, the revaluation of national currency is expected only starting 2008.

The Ukrainian stock exchange index doubled from the beginning of the year and reached 1034.38 mark at the end of September. In 3Q07 the stock index rally was interrupted by the US mortgage crisis and global liquidity crunch. In September the FSTS met its local minimum 954.14 and halted the fall only after the Fed's rate cut at the end of the month.

The consolidated budget was executed successfully by the end of September. For nine months Finance Ministry managed to preserve surplus of \$1.2 billion. Slight deterioration on the revenues side was observed due to VAT and non-tax revenues reduction in 3Q07. The budget process was postponed till the end of election campaign and new coalition formation. By the end of November the budget 2008 was still await-

ing for consideration.

The economic perspectives look quite positive. In 2008 we expect 6.5% of GDP growth. Investment demand and individual consumption should be strong underpinning industry and services performance. Inflation will be high on the back of poor harvest of current year (+15.2% y/y of CPI growth). Exports are expected to slow down (+3.6% in 2008) in line with weakening external demand. Imports are estimated to support high growth rates (+11.5%) thanks to strong internal consumption. Monetary aggregates should continue robust upward dynamics on the back of expected significant foreign currency inflow. MB is estimated to increase by 29.4% y/y while broad money supply is expected to go up by 31.1% y/y.



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CASE Consulting: 10 Starokyivska Str., office 107, Kyiv 04116, Ukraine

Tel./Fax: (+38 044) 227-53-17

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