



UKRAINE

Economic Outlook

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UKRAINE -- Economic Highlights

- Few countries can show the following combination of economic achievements over the last three years:
 - High average rate of economic growth of about 9% pa
 - Low average annual inflation rate of less than 7% pa
 - Low average fiscal deficit of about 1% of GDP
 - High current account **surplus** of more than 8% of GDP
 - Fairly stable foreign exchange rate
 - High international reserves (currently \$9.5 billion) in excess of three months of imports
 - Very low ratio of external debt to GDP of 20%

Economic Performance

	2000	2001	2002	2003	2004	2005 <u>1/</u>
Real GDP Growth	6.0%	9.2%	4.8%	9.4%	12.1%	5.0%
Fiscal Balance (% GDP)	0.6%	-0.3%	0.7%	-0.5%	-3.3%	3.8%
Consumer Inflation	25.8%	6.1%	-0.6%	8.2%	12.3%	14.7%
Exchange Rate (Hr/\$)	5.4	5.4	5.3	5.3	5.3	5.05
Current Account (\$bn)	1.2	1.4	3.2	2.9	7.0	1.7 <u>2/</u>
(as % of GDP)	3.7%	3.7%	7.7%	6.3%	11.0%	10.6% <u>2/</u>
International Reserves (\$bn)	1.6	1.7	4.4	6.9	9.5	13.0
Foreign Debt/GDP	32%	27%	24%	22%	23%	18%

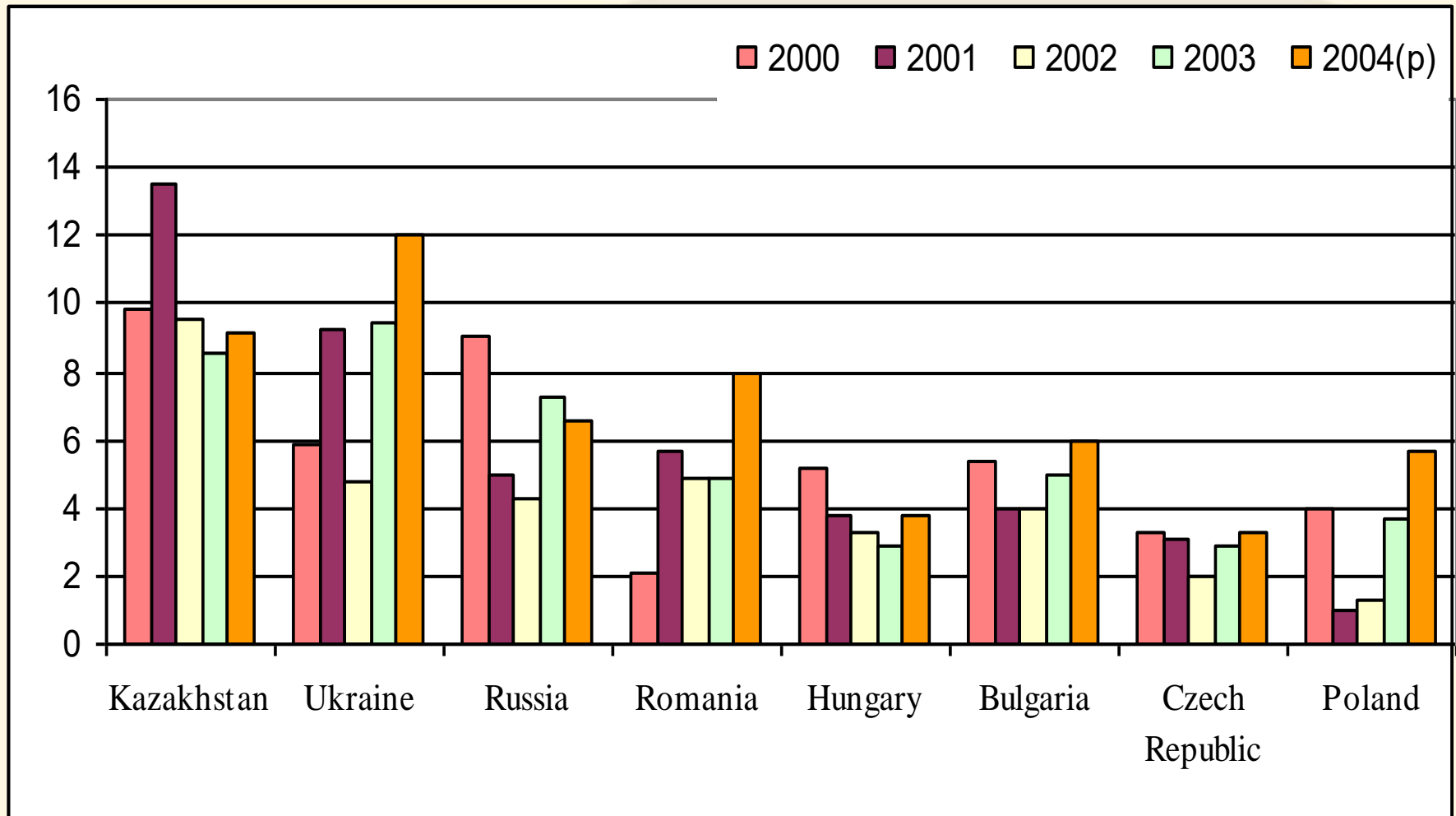
1/ Data for January-April 2005

2/ Preliminary numbers for January-March 2005

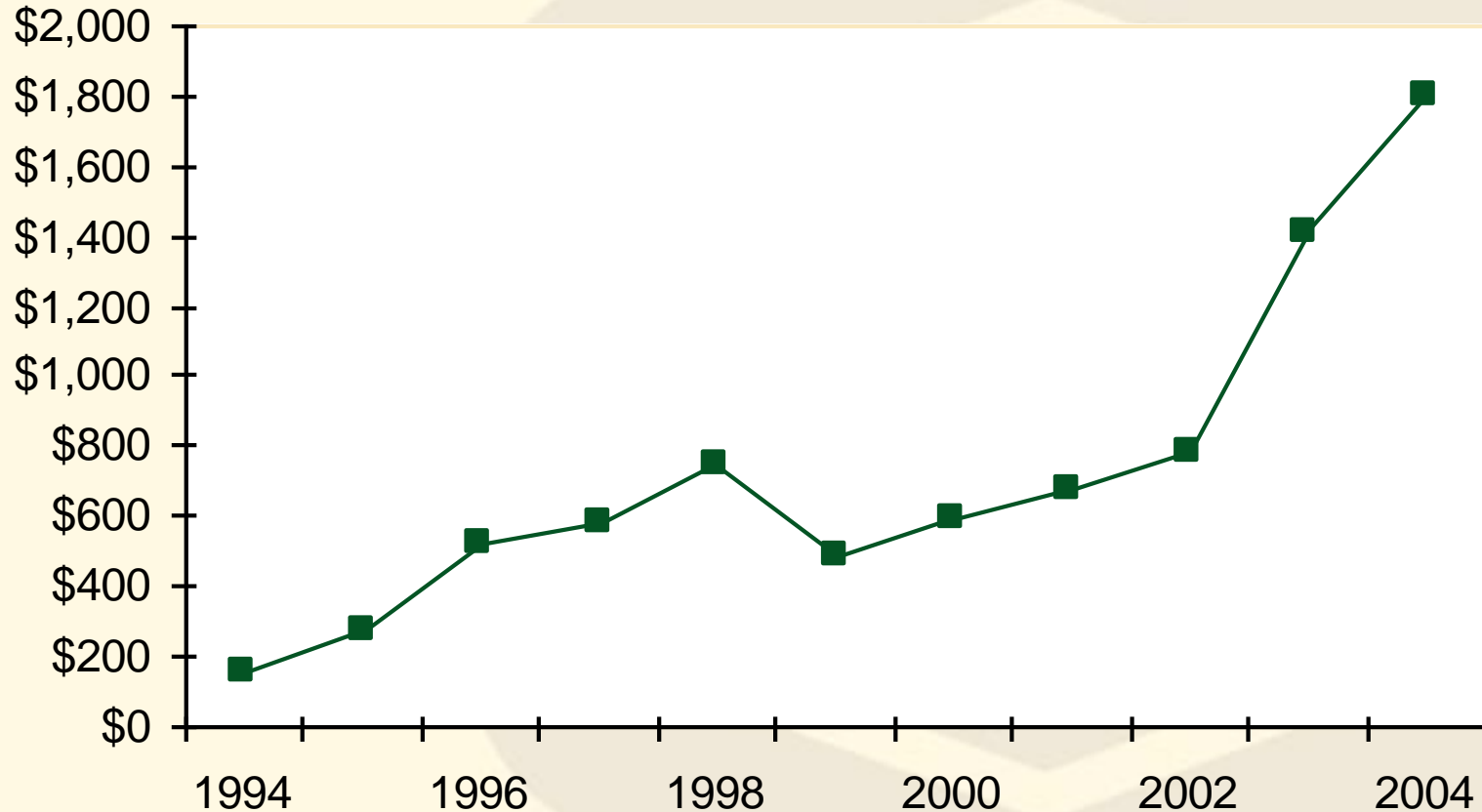
Recent Economic Developments

- In January-April, real GDP grew by 5.0% yoy supported by 7.1% and 6.8% expansion in industry and transport, respectively.
- Inflationary pressures have continued; the consumer price index increased 14.7% yoy in April (compared to 14.7% in March yoy)
- The banking system fully recovered from the liquidity crisis occurred at the end of 2004. Commercial banks managed to restore their deposit base as deposits growth sped up to 42% yoy in April.
- Good export performance and foreign investment inflow allowed the NBU to replenish its gross international reserves to \$13.0 billion by the end of April.
- The surplus in the Goods Trade Balance reached \$860 million in January-March, equivalent to 5.5% of period GDP (10.6% surplus is estimated for the current account balance).

Real GDP Growth (%) in Ukraine compares favourably with other Transition Economies:

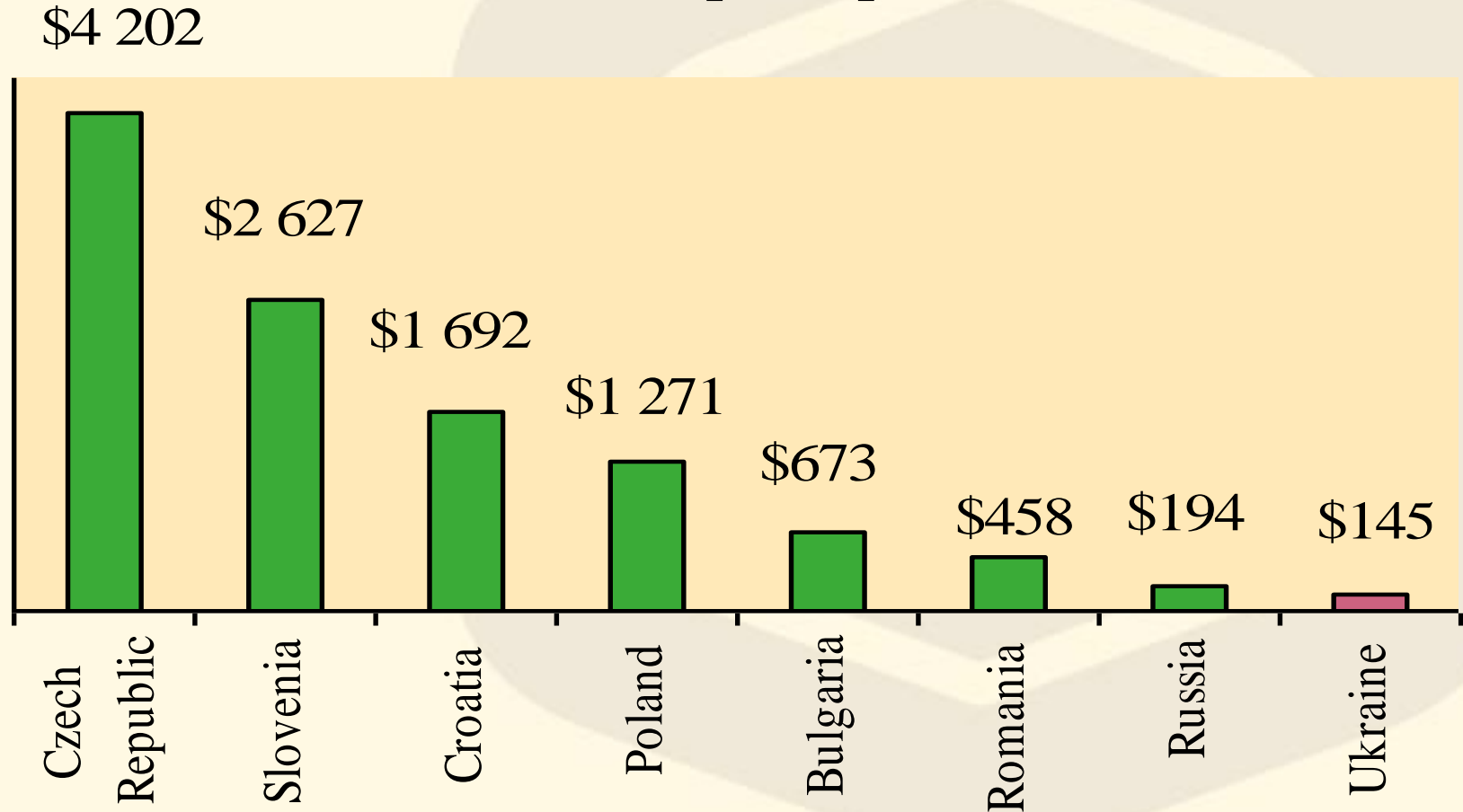


Ukraine- Net FDI inflows, US\$ million are increasing...



Despite positive inflow dynamics, cumulative FDI in Ukraine is still extremely low compared to other economies in the region....

Cumulative FDI per capita in 2003



Possible Risks to Economic Growth

- Possible high fiscal deficit in 2005 – The amended budget for 2005 envisages high social expenditures approved by the previous government in late 2004; the Government target state budget deficit of 1.6% of GDP may be hard to achieve.
- But so far, the fiscal budget shows surpluses.
- Nevertheless, inflationary pressures could continue.
- Rapid credit expansion and low quality of credit portfolio make banks vulnerable to external crises.
- Risk of external shocks -- Ukrainian growth, to a great extent led by exports, has benefited from high metal prices as metal products represent about 40% of exports
- Implementation of structural economic reforms may be handicapped by Parliamentary elections in 2006.

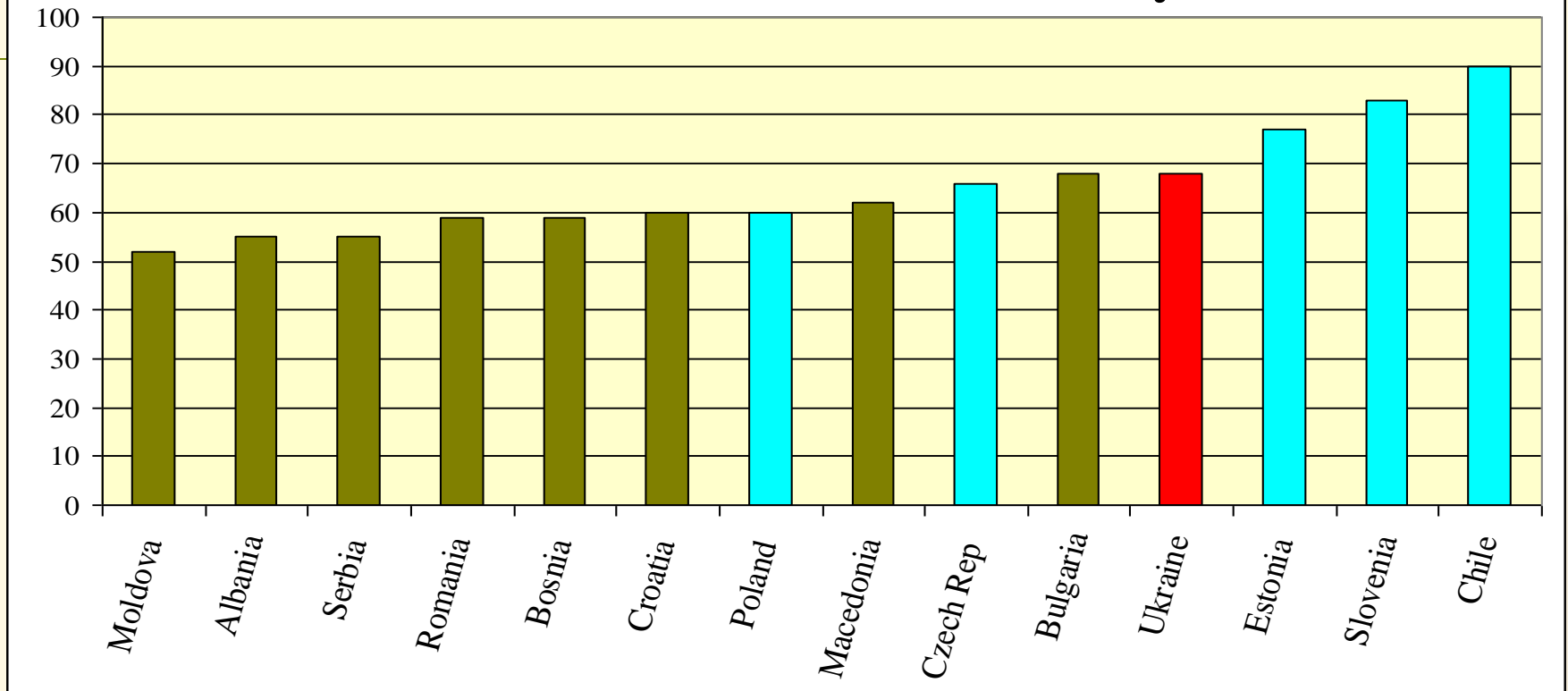
Policy Actions for Ukraine

Mr. Yushchenko is aware that to ensure sustainable economic growth over the medium term, sound monetary and fiscal policies must be maintained and must be complemented by policies facilitating sustainable investment activity (“investment drivers”).

- (1) Macroeconomic stability
- (2) Business liberalization and de-regulation policies
- (3) Stable and predictable legal environment
- (4) Corporate and public governance
- (5) Foreign trade liberalization and international capital movements
- (6) Healthy financial sector
- (7) Corruption
- (8) Political uncertainties
- (9) Country promotion and image

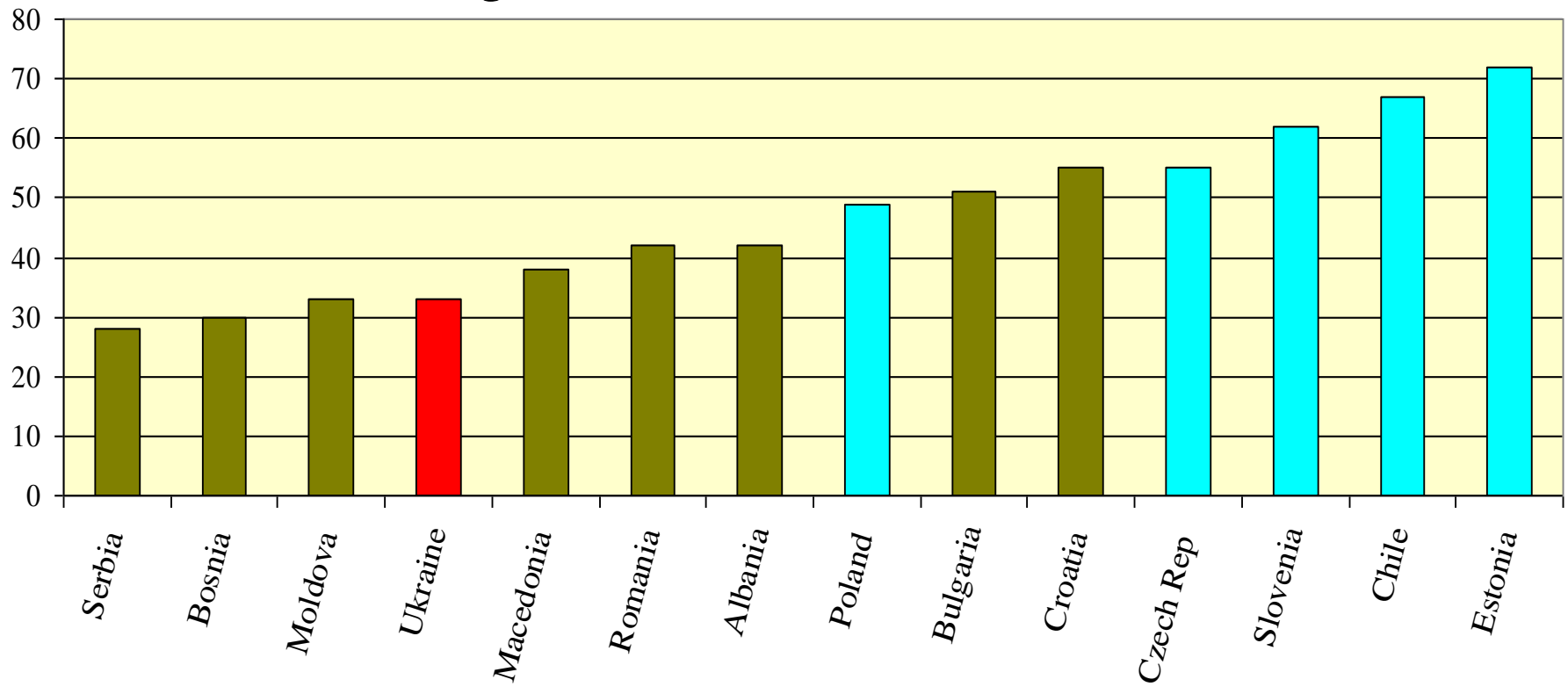
How does Ukraine compares with other regional countries on these investment drivers?

Driver 1: Macroeconomic Stability



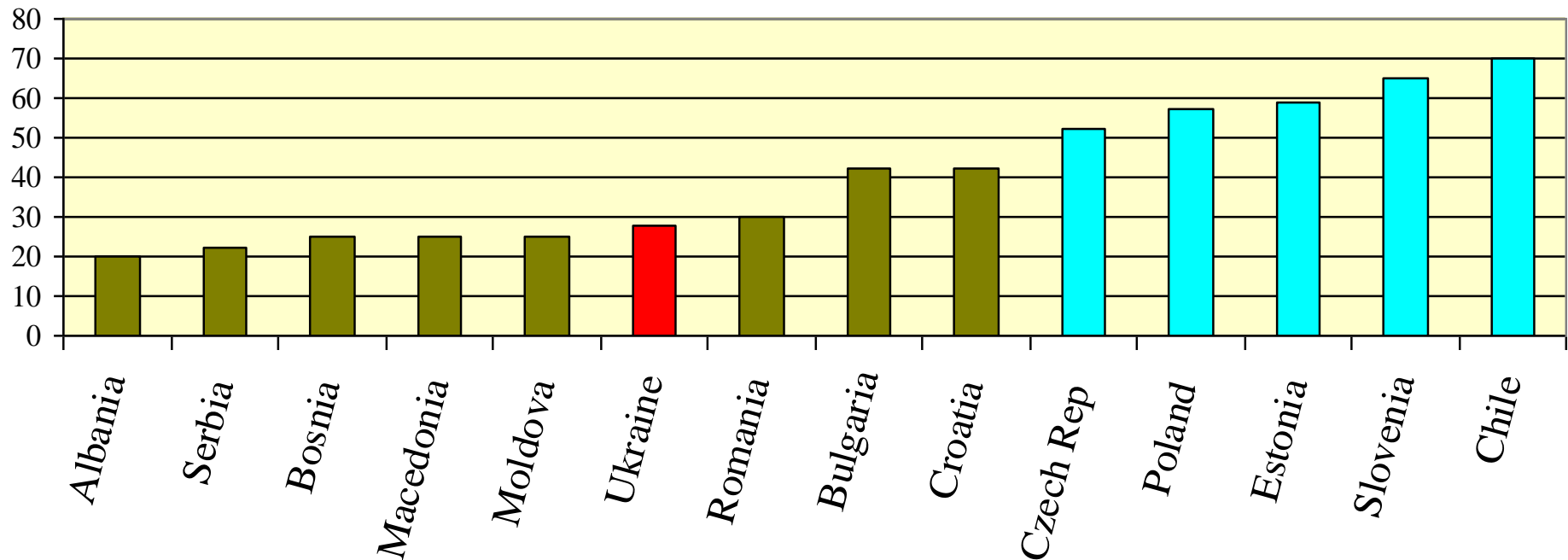
- Further deal with inflationary pressures that resulted from recent fiscal loosening (increase in pensions).
- For the future, fiscal sustainability will require the execution of a comprehensive “audit” of the public sector and its role.
- Strengthen monetary and foreign exchange rate policies.

Driver 2: Deregulation/Liberalization of Business Activities



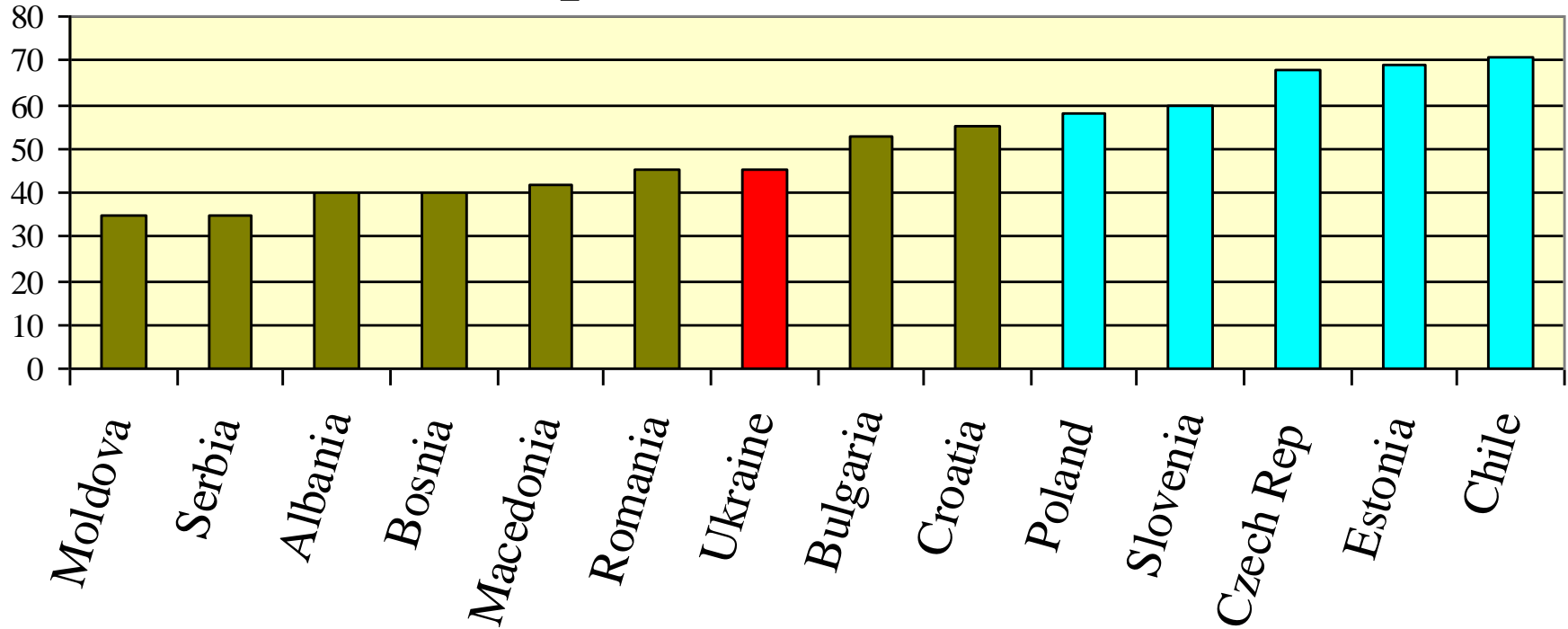
- Carry out a quick & drastic de-regulation (possible based on the "regulatory guillotine" principle that establishes a deadline)
- Eliminate excessive Government interventions in businesses
- Abolish the incentives of state agencies to intervene in business

Driver 3: Stability/Predictability of Legal Environment



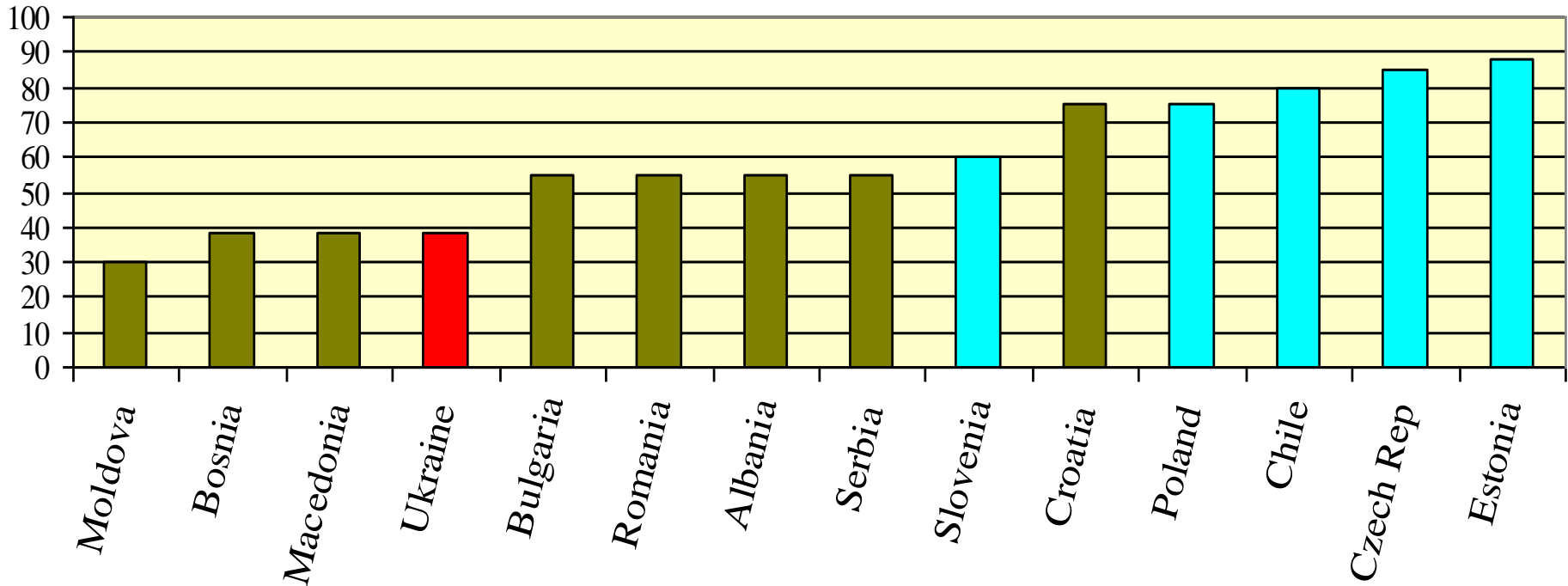
- Ensure Judiciary independence by improving financing of courts, increase salaries of judges, and improve training programs
- Enhance commercial courts for settling disputes
- Improve procedures for drafting of legislation and enact key pending legislation, such as the Adm. Court Procedures Code.

Driver 4: Corporate & Public Governance



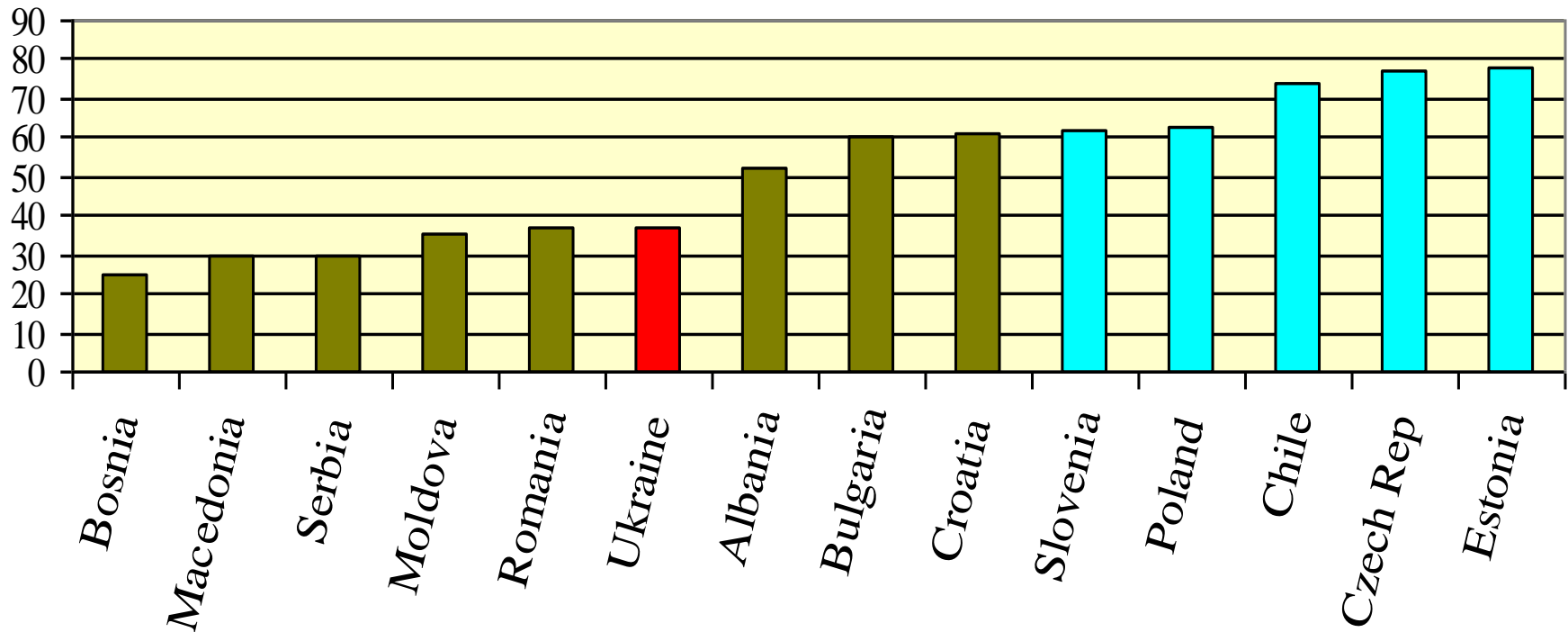
- Adopt the Joint Stock Company Law, according to international standards and develop corporate governance codes
- Carry out a comprehensive public administration reform to define role of government, cut corruption and streamline decision-making
- Establish transparent and competitive privatization procedures and clarify policy on past privatizations

Driver 5: Liberalization of Foreign Trade/Capital



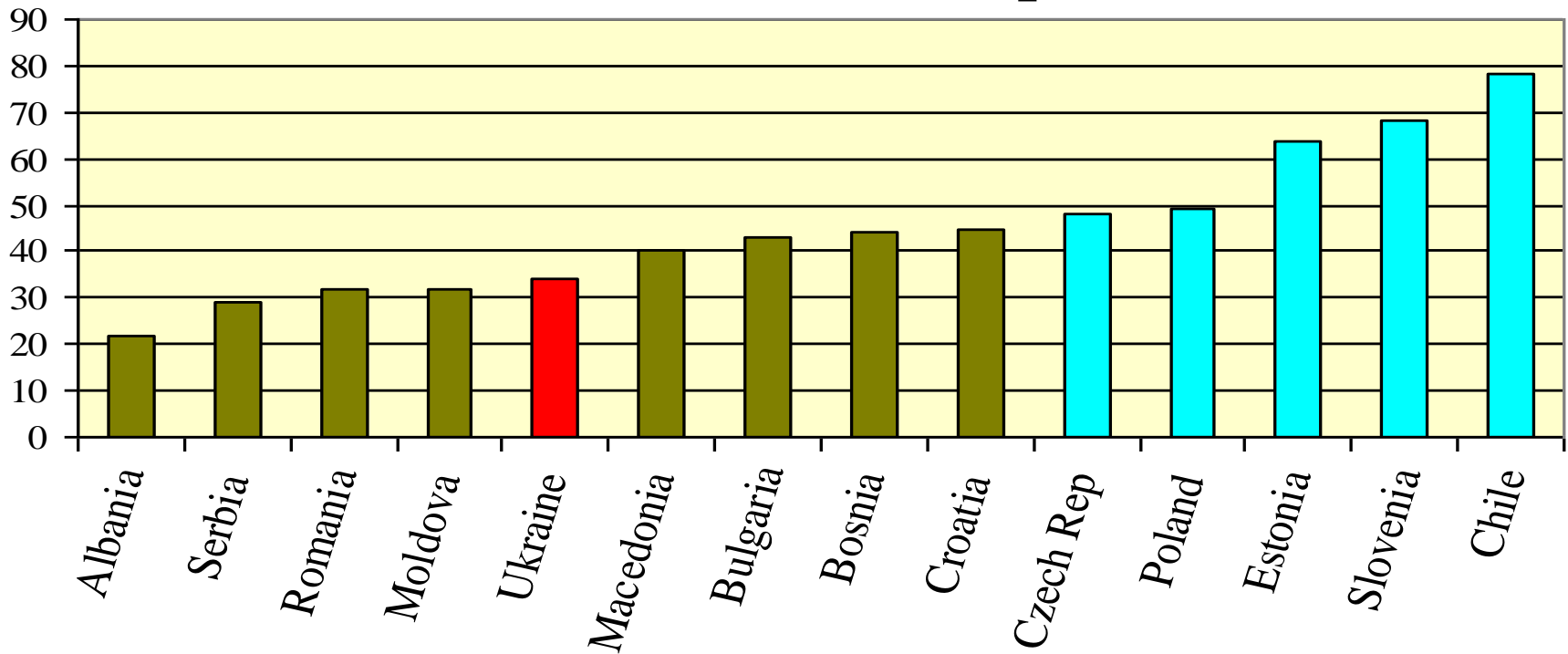
- Secure market economy status from the EU and the US and entry into the WTO
- Sign Free Trade Agreements with the country's main trading partners (EU, USA, CIS countries)
- Streamline customs procedures and formalities to ensure prompt consideration and to reduce rent-seeking

Driver 6: Financial Sector Development



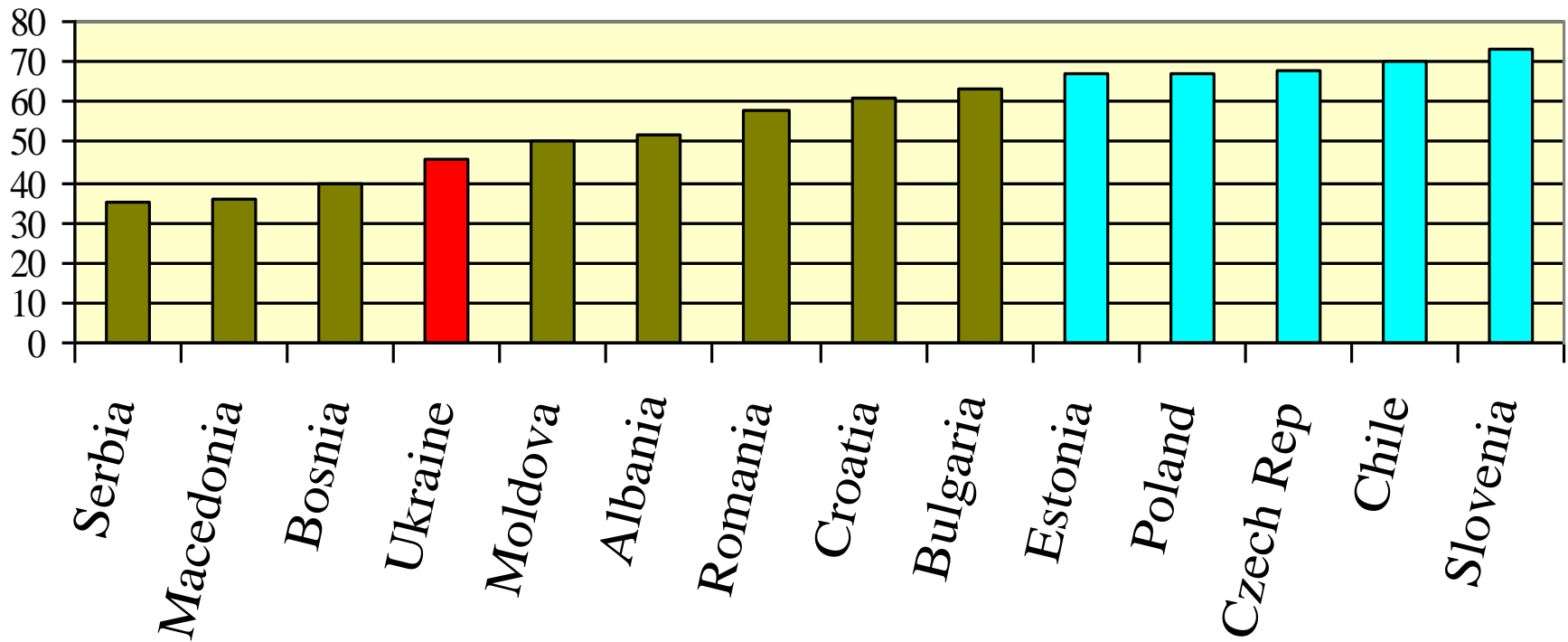
- Further improve banking supervision, including stronger prudential regulations (loan classification and provisioning, capital adequacy, lending to related companies, etc.);
- Encourage stock market transactions to be made on the organized market;
- Facilitate the development of private pension funds.

Driver 7: Non-Corruption



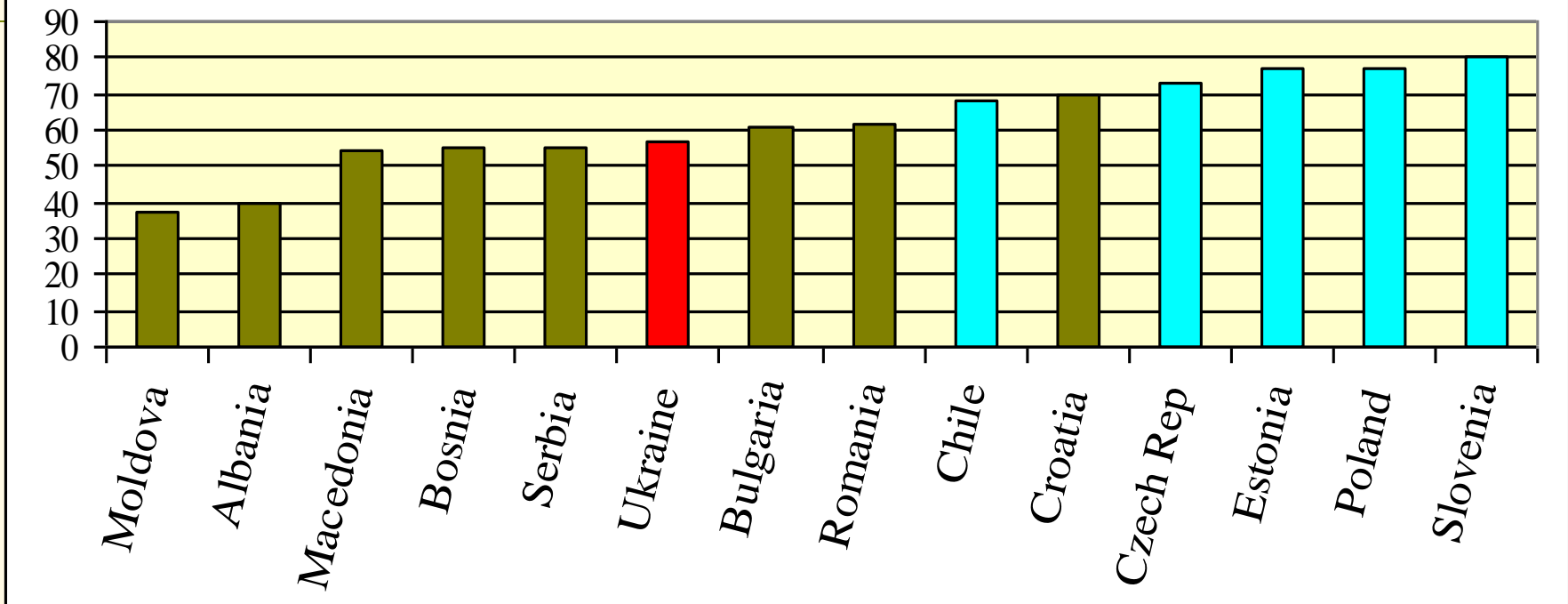
- Implement public administration reform to improve transparency of decision-making process;
- Reduce the ambiguity of government regulations and raise accountability of the public servants for their decisions;
- Strengthen the internal audit office.

Driver 8: Political Risks



- Take measures to eliminate power abuses at different levels of the authorities.
- Deal with the perception that the government is not united
- Decentralize some government activities to diffuse regional disparities and concerns.

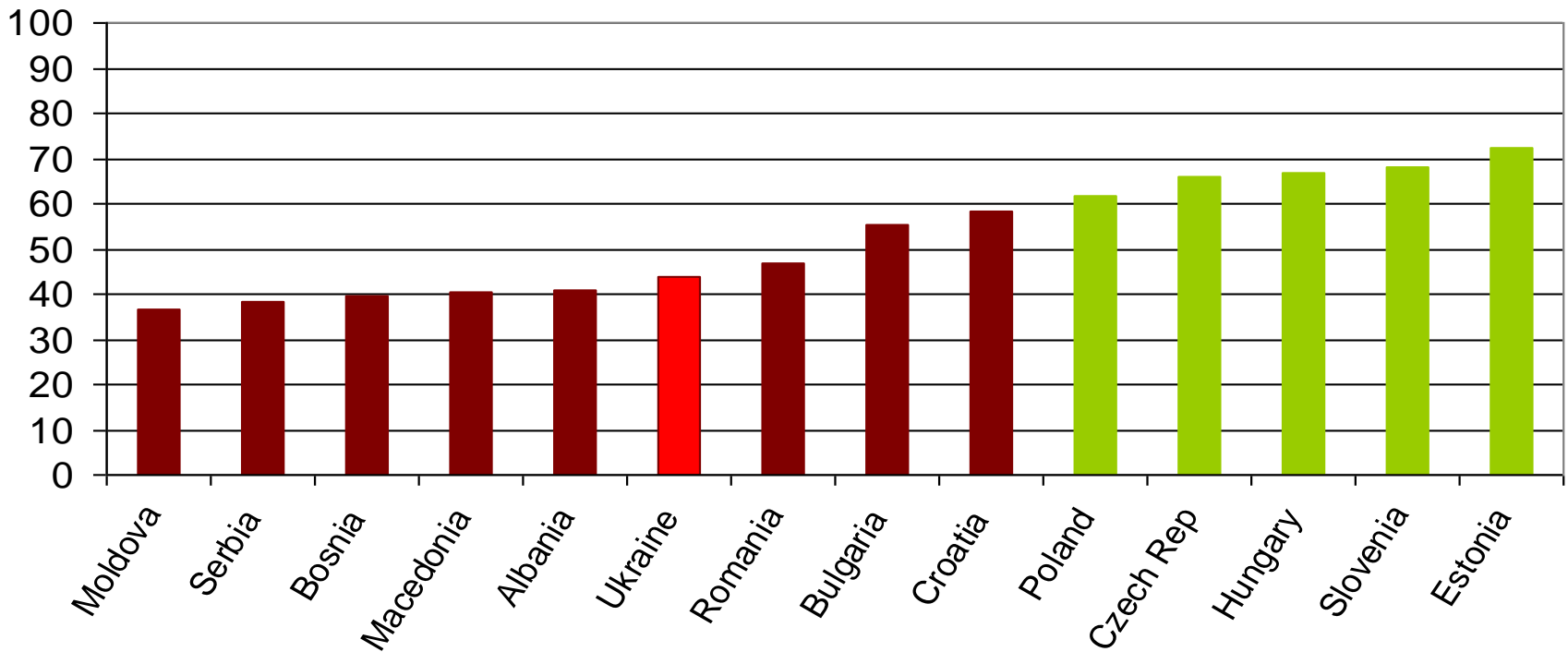
Driver 9: Country Promotion & Image



- Improve image through better and more frequent communications and transparency
- Continuously interact with representatives of the private sector in to learn the problems they are facing.
- Ensure effective functioning of the investment promotion agency;

Overall Investment Drivers – Country Ratings

Aggregate Investment Attractiveness Ratings



Mr. Yushchenko's Presidency: First Steps

- Yushchenko's track record both as Chairman of the National Bank and Prime Minister set the basis for Ukraine's recent impressive economic performance, and bode well for Ukraine's future
- The following reforms and changes have been taken by the new government since the beginning of 2005:
 1. On March 25, 2005, an amended Fiscal Budget for 2005 was approved by Rada, eliminating most tax privileges and exemptions, and reducing privileges of free economic zones. The amended Budget envisages a 1.6% of GDP deficit. This deficit was calculated based on the following macroeconomic assumptions:
 - Real GDP growth 8.2% yoy in 2005
 - Consumer inflation 9.8% eop
 - Producer inflation 17.5% eop
 - Significant increases in tax revenues as % of GDP

.....Mr. Yushchenko's Presidency: First Steps

2. Steps were taken to reduce the size of the shadow economy (extensive anti-smuggling campaign --Smuggling-STOP -- performed by customs authorities). The campaign has yielded its first results. In March, the State Customs Committee collected 42% more customs duties than was targeted for the period, while import volumes did not increase significantly.
3. On the path to foreign currency market liberalization, the NBU abandoned its regulation requiring the mandatory sale of 50% of exports proceeds starting April 1, 2005.
4. On April 29, 2005, the NBU cancelled its regulation #482 that required multiple conversion of currencies for non-residents investing into Ukrainian enterprises
4. The country has developed stronger working relationship between Ukraine and the West
5. Increased interest and support from international institutions (WB, IMF and EBRD)

.....Mr. Yushchenko's Presidency: First Steps

6. The Privatization strategy is currently under revision. Disputed privatizations will be limited in number (the declared list contains 29 enterprises). The Kryvorizhstal deal will be resolved soon (court proceedings are under way). Other disputed privatizations will be settled in the courts too.
7. A number of reductions of import duties and introduced changes in customs procedures to streamline customs clearance of goods coming into Ukraine were proposed by the new government. These initiatives has yet to be approved by the Parliament.

Future Reform Agenda

SigmaBleyzer/The Bleyzer Foundation developed for the government a set of policy recommendations:

■ **Short Term Reforms:**

- Perform quick deregulation and liberalization of business activities by implementing a “regulatory guillotine”
- Eliminate other excessive administrative interventions in businesses (price controls, regulations 482)
- Enact key pending legislation (e.g., the Joint Stock Companies law)
- Improve image through more frequent communication and better transparency.
- Clarify the Government’s policy on Privatization
- Create an Investment Promotion Agency
- Implement specific promotional activities for large investors: Identify major projects, carry out targeted promotional campaigns, identify niches/sectors.
- Implement specific promotional activities for small/medium firms: access to bank credit, better information on laws, and the business environment

..... Future Reform Agenda

■ Long Term Reforms

- Ensure “sustainable” fiscal deficits and low inflation (the 2005 deficit can be financed and capital expenditures curtailed; thereafter, the budget must be sustainable).
- Implement a fundamental public administration reform by undertaking a comprehensive “audit” of government activities (this will help to improve administrative efficiency, deal with corruption and also bring equilibrium to the fiscal budget)
- Strengthen monetary and foreign exchange rate activities (to abandon the exchange rate anchor, techniques for inflation targeting must be developed – open market operations, forecasting models)
- Liberalize trade and sign free trade agreements with the CIS, EU, US and other countries
- Improve the legal environment (particularly by ensuring the independence of the Judiciary.)