

ICPS newsletter[®]

Ukraine's economy in 2004: top experts share common vision

Participants in the Consensus-Forecast project have come up with forecast indicators for Ukraine's economy in 2004. In their opinion, GDP will grow more slowly, amounting to 7.8% in 2004, as opposed to 8.5%¹ in 2003. Annual inflation is expected to level out at 8%. In 2005, GDP growth is expected to drop again, to 6.5%. Still, the forecast for most indicators has been upgraded from the previous consensus-forecast, made in September 2003

The latest expert session on forecasting macroeconomic indicators organized by the Ministry of Economy and European Integration (MEEI) within the Consensus-Forecast project took place 26 February 2004 and involved government and NGO specialists, and representatives of business. They reviewed the macroeconomic results for 2003 and presented forecasts for key indicators for 2004–2005.

Pessimistic expectations in 2003 forecasts failed to materialize

2003 results are looking to surpass all expert predictions. For instance, according to preliminary data, GDP grew 8.5% in 2003, which took even the most optimistic forecasters by surprise: the September consensus-forecast for GDP growth was only 5.7%. In experts' opinion, this underestimation of last year's results was caused by negative expectations for Ukraine's economic development right from the start of the year: the threat of FATF sanctions, anticipated poor harvests for most crops, and shrinking foreign investment as relations with the USA and EU worsened. Other reasons for pessimism were:

- underestimated global economic growth and the strengthening of the euro against the US dollar;
- softer monetary policy in Ukraine, which turned out to be an additional driver of GDP growth and spurred higher inflation;
- difficulties in predicting the effect of legitimizing the economy, that is, the emergence of business from the shadows.

¹ Preliminary data from Derzhkomstat, the state statistics committee.

The economy keeps on growing

Ukraine's economy continues to grow steadily, though the quality of this growth is not unambiguous positive. It is being driven, not by increased productivity or greater industrial efficiency but by favorable conditions on external markets where demand has grown for low value-added exports from Ukraine.

According to forecasts, this favorable external situation will continue in 2004, although the expansion of the EU to include 10 new member-countries in May will cost Ukraine some important markets for its goods. In the opinion of experts, Ukraine will continue entering new international markets and will accede to the WTO in 2005. In 2004, the euro will continue to strengthen against US dollar on international markets.

In the domestic sphere, consumer demand will grow, thanks to lower individual income tax rates, rising minimum wages, and increased government spending on social benefits in the run-up to the presidential election. The need to increase and upgrade fixed assets will lead to a steep rise in investment growth. Still, the ratio of fixed asset investment to GDP will remain at about 20%, which is unacceptably low for a country with a transitional economy.

No fluctuations in the hryvnia-to-dollar rate are expected. Yet, experts did not agree as to whether monetary policy would tighten in response to growing inflation.

The reduction of certain taxes rate that came into effect at the beginning of

Designing a macroeconomic model

Specialists from the Ministry of Economy and European Integration, the Ministry of Finance, the National Bank of Ukraine, the Conference Board of Canada, and the International Center for Policy Studies continue to develop the macroeconomic model previously designed in the framework of "Economic modeling and forecasting in Ukraine" project.

In Kyiv from 25 February to 5 March 2004, Mr. Pedro Antunes, one of the model's designers and a consultant on this project, is handling the process of preparing equations and defining the specifications of the model. These have to be adjust for changes that have taken place in Ukraine since the first version of the model was presented, at the end of 2002. For now, the second phase of the project is aiming at enhancing the model and introducing it into everyday use at the appropriate government agencies. For more information, see ICPS Newsletters №124 and №154, or check the internet at:
http://www.icps.kiev.ua/projects/economic_modelling.html.

2004 will cut into Budget revenues. The negative impact of this factor will be partly compensated by the expected repeal of tax holidays, in particular VAT exemptions. In comparison with the September forecast, economists expect even more that the Budget deficit will be defrayed at the cost of external borrowings. Privatization revenues will remain at 2003 levels, 2.1 billion UAH. In the opinion of some non-government experts, the problem of delayed VAT reimbursements to exporters will remain unresolved.

Economists anticipate their 2004 forecast to come true, provided that the economy does not suffer major setbacks caused by political factors, substantial declines in

export revenues, or significant Budget shortfalls as a result of reduced tax rates. Key Consensus-Forecast indicators and changes since the previous seminar are presented in Table 1.

This seminar is held with the support of the United Nations Development Program (UNDP) under the auspices of its Economic and Social Development

Project (ESDP). Forecasts are submitted by the following organizations: the Support Group of Coordination Council on Financial Sector Policy Issues, the Institute of Economic Research and Political Consultations, the Institute of Economic Forecasting of the National Academy of Science, such companies as Dragon Capital, GfK-USM, Alfa and K, as

well as MEEI, the NBU, the IMF Resident Representative Office, the World Bank Country Office, and ICPS. ■

ICPS has published its quarterly predictions for economic development in Ukraine since 1997. For further information on ICPS forecasts, contact Andriy Blinov at +380-44-236-1292 or e-mail at ablinov@icps.kiev.ua.

Table 1. Average macroeconomic forecast for 2004

Index	Consensus forecast			ICPS forecast	Index	Consensus forecast			ICPS forecast
	Current	Previous	Trend	Current		Current	Previous	Trend	Current
Real sector	(mill UAH)				Official transfers (net)	3.5	3.4	↑	3.5
Nominal GDP	303,434	277,584	↑	295,000	Capital account	-3.4	-2.7	↓	-0.9
Consumption	232,877	212,201	↑	225,000	FDI	2.1	1.7	↑	1.8
private	179,337	156,567	↑	169,100	Exchange rate	(UAH/USD)			
public	53,668	55,634	↓	55,900	Average annual	5.34	5.37	↓	5.33
Investment	64,636	57,210	↑	66,700	Year-end	5.35	5.40	↓	5.34
Gross accumulation					Public finances	(mill UAH)			
of fixed capital	64,397	58,663	↑	x	Total revenues	81,568	74,980	↑	79,650
private	53,536	49,649	↑	x	Total expenditures	84,949	77,186	↑	84,075
public	8,892	6,868	↑	x	Overall balance	-3,381	-2,206	↓	-4,425
Net exports of goods					<i>Financing items</i>				
and non-agency services	6,494	8,070	↓	5,100	Privatisation	2,325	2,170	↑	3,000
Gross national savings	77,942	70,479	↑	79,226	Domestic borrowing	294	705	↓	-175
					Foreign borrowing	1,187	165	↑	1,600
Real sector	(index, year-over-year)				Public finances	(% of GDP)			
Real GDP	107.8	105.5	↑	106.5	Total revenues	26.9	27.0	↓	27.0
Consumption	108.6	106.0	↑	108.4	Total expenditures	28.0	27.8	↓	28.5
private	110.3	107.7	↑	109.5	Overall balance	-1.1	-0.8	↓	-1.5
public	103.2	101.3	↑	105.0	<i>Financing items</i>				
Investments	110.9	109.1	↑	108.0	Privatisation	0.8	0.8	=	1.0
Gross national savings	110.5	105.6	↑	x	Domestic borrowing	0.1	0.3	↓	-0.1
					Foreign borrowing	0.4	0.1	↑	0.5
Inflation	(index)				Money and credit	(mill UAH)			
GDP Deflator					Monetary base, year-end	49,148	55,280	↓	51,300
(average annual)	108.0	106.6	↑	107.5	Dec. to previous Dec., %	22.6	29.0	↓	28.0
CPI (average annual)	108.0	106.5	↑	107.8	Money supply (M3), year-end	121,999	126,318	↓	131,100
Dec. to previous Dec.	107.2	105.9	↑	106.5	Dec. to previous Dec., %	28.4	34.2	↓	38.0
PPI (average annual)	109.2	105.8	↑	111.0	Average weighted				
Dec. to previous Dec.	107.4	105.3	↑	108.0	interest rate on				
External Sector	(mill USD)				commercial bank hryvnia				
External Sector	2,551	2,474	↑	2,370	loans, %, average annual	15.0	16.4	↓	17.6
Export volumes	32,309	28,086	↑	32,540	NBU international				
Import volumes	31,170	26,692	↑	31,600	reserves, mill. USD	8,427	8,040	↑	8,800
Revenues balance	-575	-657	↑	-513	Social indicators				
Official transfers (net)	1,987	1,737	↑	1,935	Population, mln. of people	47.37	47.43	↓	47.3
Capital account	-1,909	-1,375	↓	-500	% change over previous year,	99.4	99.3	↑	99.4
FDI	1,176	895	↑	1,000	Average wage, UAH	533.8	522.1	↑	516.0
					% change over previous year,	109.6	111.4	↓	106.5
External Sector	(% of GDP)								
External Sector	4.5	4.8	↓	4.3					
Export volumes	56.8	54.3	↑	58.8					
Import volumes	54.8	51.6	↑	57.1					
Revenues balance	-1.0	-1.3	↑	-0.9					

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