Quarterly Predictions

#17, October 2001

Contents

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MAJOR INDICATORS

	1996	1997	1998	1999	2000	2001	2002	2003
							(forecast)	
Economic activity								
GDP, *billions UAH*	81.5	93.4	102.6	130.4	173.0	203.8	228.3	258.9
Real GDP, *apc**	-10.0	-3.0	-1.9	-0.2	5.8	8.0	4.5	6.0
Real industrial production, *apc*	-5.1	-1.8	-1.0	4.3	12.9	14.0	6.0	9.0
Real agricultural output, *apc*	-9.5	-1.9	-9.8	-5.7	7.6	10.0	6.0	5.0
Gross investment, *% GDP*	22.7	21.5	20.7	17.4	18.6	20.6	21.7	23.0
FDI, *millions USD (1)*	526	581	747	489	594	900	1100	1100
Real household disposable incomes, *apc*	-12.3	5.1	-5.8	1.2	11.1	10.5	7.0	8.0
Real retail trade, *apc*	-11.1	8.2	-3.5	-4.8	7.5	10.0	6.5	6.0
Prices								
Consumer price index, *apc*	40	10	20	19	26	6	8	6
Producer price index, *apc*	17	5	35	16	21	2	6	7
Labour market								
Population, *millions*	51.1	50.5	50.1	49.7	49.3	48.9	48.8	48.7
Real wage, *average apc*	-2.5	-0.4	-2.8	-5.7	1.0	9.0	3.5	4.5
Official unemployment rate, *%*	1.3	2.3	3.7	4.3	4.2	4	4.5	5.5
Foreign economic activity								
Exports of goods&services, *apc*	19.1	0.0	-13.4	-7.9	20.3	10.0	3.5	5.5
Imports of goods&services, *apc*	17.1	-1.1	-17.0	-19.1	18.9	15.0	8.0	6.0
Current account balance, *% GDP*	-2.7	-2.7	-3.0	2.6	4.7	2.4	-0.3	-0.7
Budget								
Revenues (consolidated), *% GDP (2)*	28.2	30.1	28.2	25.9	28.4	25.6	24.4	23.8
Balance (IMF methodology), *% GDP*	-3.2	-5.6	-2.7	-2.4	-1.1	-1.2	-1.6	-1.0
Monetary indicators								
Monetary base, *apc*	38	45	22	39	39	33	17	14
M3, *apc*	35	34	25	41	45	34	19	16
NBU international reserves, *millions USD*	1972	2359	793	1094	1539	2550	2840	3200
Official exchange rate (average annual) *UAH/USD*	1.83	1.86	2.45	4.13	5.44	5.38	5.63	5.85
Loan interest (average annual), *yearly % (3)*	77	49	55	53	41	32	28	25
International								
World GDP, *apc*	4.3	4.2	2.5	3.3	4.7	1.6	1.7	2.8
GDP of Ukraine's major trading partners (2/3 of exports), *apc*	1.4	0.8	1.3	3.0	6.0	2.6	3.0	3.7

* *apc* = annual percentage change

Notes: (1) according to the NBU;
(2) calculated by IMF methodology since 2001;
(3) commercial bank loans, UAH

Source: State Statistics Committee, NBU, Finance Ministry; calculations and forecast by Quarterly Predictions.

OVERVIEW

We forecast that in 2001, the gross domestic product (GDP) of Ukraine will increase by 8%. In 2002, Ukraine's economic growth rate will slow to 4.5%; however, it will again speed up, in 2003to 6%. These economic trends are influenced by a variety of factors—on the one hand, the global economic slowdown, and on the other hand, continued growth of domestic demand

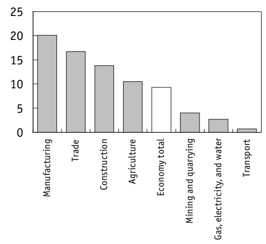
Economic activity

Over the first three quarters of 2001, the GDP of Ukraine increased by 9.3% y-o-y. Such a positive change was triggered by accelerated growth in construction and in agriculture (see **AGRICULTURE**). Meantime, the same indicator in industry persisted in its decline, primarily due to restrictions of export opportunities (see **BUSINESS**).

In 2002, Ukraine's economic growth will slow down, however in 2003, it will rebound

We forecast that by year-end, the GDP will increase by 8%. We have decreased our forecast for Ukraine's economic growth in 2002, to 4.5%. However, in 2003 this indicator will again rebound, to 6%.

Gross value added
in Jan–Sep 2001,
annual % change



Source: State Statistics Committee.

Our pessimistic estimates apply mostly to the foreign trade forecast (see **EXTERNAL**), where the trade balance will go into the red already in Q4'01. In 2002, this indicator will continue to deteriorate, owing to decelerated export growth. The forecast for foreign economic activity in 2002 is based on the following assumptions:

- deteriorating conditions in the global economy (see **INTERNATIONAL**); we have reduced our 2002 forecast for GDP growth of Ukraine's trade partners by 1 percentage point, to 3%;
- intensification of anti-dumping measures in developed countries and, likewise, in CIS countries, as a reaction to the slowing economy;
- real hryvnia appreciation (see **MONETARY**) in 2000–2001, which will affect the conduct of Ukrainian exporters in 2002.

In 2003, the export growth rate will increase, thanks to the revived global economy. According to our forecast, the GDP of Ukraine's trade partners will increase by 3.7%. Nevertheless, Ukraine's foreign trade balance in 2003 will again be negative, with imports steadily increasing in both 2002 and 2003, and prevailing over exports.

Russia and other CIS countries are quite likely to maintain a high growth rate. These economies have begun to flourish recently and possess a considerable unrealised potential; therefore, the global economic downturn will affect these regions only slightly. The market power of Ukrainian exporters in these countries may turn out to be better than we expect, which represents a positive opportunity for the Ukrainian economy.

Thanks to increased domestic demand, Ukraine's economy will manage to partially compensate for slow export growth

The increased domestic demand will allow the Ukrainian economy to compensate to some extent for a slowed export growth rate. Household consumption will serve as a strong impetus boosting domestic demand. The consumer confidence survey conducted by the International Centre for Policy Studies together with the GfK-USM company reveals that it improved again during Q3'01, with the average-income bracket being the most optimistic. Given the positive opinion of these most active consumers, and a strengthening trend among consumers to make large purchases, we can anticipate increased demand.

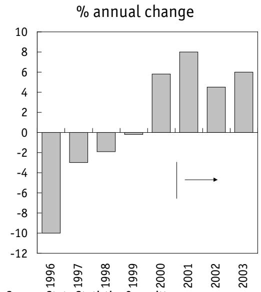
Figure 1. Real GDP

Index, seasonally adjusted, Q1'95=100

Source: State Statistics Committee; calculations and forecast by Quarterly Predictions.

For the time being, though, we forecast slower growth in investment for 2002–2003. Investment in 2002 will also be hampered by the following circumstances: (1) decreased profits of exporting enterprises, which will limit investment sources; and (2) generally pessimistic attitudes among enterprise managers, due to noticeably deteriorated foreign market conditions.

Real GDP,
% annual change



Source: State Statistics Committee; calculations and forecast by Quarterly Predictions.

In addition, it was the lack of a consistent state policy regarding infrastructure sectors that induced us to revise our forecast. We consider a common problem of these sectors to be ineffective management, i.e., the limited influence of private owners, and the government's failure to set long-term development objectives for these sectors and to monitor their execution. Moreover, privatisation itself will not solve these sectors' problems. We believe that an integrated policy on state regulation, resting on public goals and market frameworks, needs to be developed in these sectors.

In the transport industry, state authorities continue to perform both regulatory and managerial functions, which leads to abuses of power and redirection of state funds to the private sector. The government's support of vested interests of power-consuming industrial enterprises is manifested in delaying the adoption of decisions to raise tariffs on electricity; under these circumstances, enterprises in the sector will incur losses. The situation in the telecoms sector has turned out to be comparatively better, thanks to intensified competition. However, the sector lacks coordinated rules regulating interaction between market agents.

The absence of reforms in the above sectors poses a threat to overall economic development (see **BUSINESS**). Moreover, inefficient resource allocation in the healthcare system reduces the quality and accessibility of medical services; this casts a shadow on the quality of economic growth in Ukraine (see special chapter this issue: **HEALTHCARE**).

Our forecast for increased investment growth in 2003 compared to 2002 is based on the probable reduction of direct taxes after the adoption of the Tax Code.

Financial stability

The trade balance will drop into the negative and will affect the exchange rate trend in the currency market; thus, the hryvnia will depreciate, albeit insignificantly. The prospects for Ukraine's economic growth will stimulate the influx of foreign capital, especially during the privatisation process. Meantime, renewed hryvnia devaluation after two years of stability may provoke greater fluctuation of the currency exchange rate (see **MONETARY**).

Among the factors determining the low inflation rate in 2002–2003, the major ones will be a slower rate of money emission, a low budget deficit, and an economic upturn. Over this period, price shocks may occur from increased tariffs in the infrastructure sectors (see **PRICES**).

Hryvnia real exchange rate will stabilise

These developments of the nominal exchange rate and of consumer inflation will assure the stability of the hryvnia real exchange rate. And hence, the purchasing power of the Ukrainian currency will remain largely unchanged, compared to other monetary units.

A hazard to financial stability is the possible increase of the budget deficit

The main hazard to financial stability in Ukraine will be the possibility of a bigger budget deficit. In 2002, a disbalance may be triggered by the dependency of budget execution on privatisation, and by a worse economic dynamic than that estimated in the budget. In 2003, the Tax Code implementation will lead to decreased tax revenues; meanwhile, the government may not be able to concomitantly reduce expenditures.

The **QUARTERLY PREDICTIONS** group was established in September 1997 by the International Centre for Policy Studies in cooperation with the New Zealand Institute of Economic Research.

The **QUARTERLY PREDICTIONS** journal presents our forecast of Ukraine's economic performance based on comprehensive research of all its sectors. These forecasts are estimations based on the information available up to the stipulated date. This issue was prepared using information available up to 15 November 2001.

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