Ukraine- Forschungsgruppe at IOS in cooperation with IER Kiev:
Spotlight Ukraine: Monthly Economic Monitor May 2014

- **IMF**. On April 30, the IMF Executive Board approved SDR 11.0 bn (USD 17.1 bn at current exchange rate) Standby Arrangement (SBA) for Ukraine. It is divided in eight tranches ending in March 2016. On May 7 Ukraine has already received SDR 2058 m including SDR 1290 m for budget supports. The conclusion of the SBA was a precondition for support from IFIs and bilateral official creditors. It is also likely to unlock access to private financial markets after political situation stabilizes. New SBA as well as other international funding will support comprehensive program of economic reforms. The initial goal of reforms is to restore macroeconomic and financial stability with ambitious structural reforms further on the road. Reform agenda will be developed in close consultations with the IMF and other donors. In 2014 reviews of the SBA are planned in June-July, August-September and November-December. The next three instalments of the IMF loan are contingent on these reviews and new reforms will likely be planned as a result of studies mandated by the SBA.
- The outlook for the conflict in Donetsk and Luhansk regions is likely to be negative as all attempts to resolve the situation through negotiation, including at the international level, failed. The Government faces a choice between two options: intensify military actions against separatists or lose effective control of the regions. Both options will have negative economic consequences, including a possible disruption of the economy in the two regions. The conflict may also spread to other regions in the East and in the South of Ukraine. The risk of civil war also exists as pro-Ukrainian activists may start resisting separatists by force. However, the risk of cancellation of the presidential election in Ukraine is rather low. On the bright side, the conflict gave a stronger incentive to developed countries to provide financial and technical aid to Ukraine.
- ***The EU.*** On April 23, the European Union's regime of autonomous trade preferences to Ukraine came into force. Specifically, the EU removed tariffs for 94.7% of industrial products (except for processed food products), 82.2% of agricultural goods, and 83.4% of processed food products exported from Ukraine. For some other goods, including cereals, pork, beef, and poultry, duty-free tariff rate quotas were introduced. The action was intended to support Ukraine before the country signs the remaining chapters of the Association Agreement (AA) with the EU, thus establishing a Deep and Comprehensive Free Trade Area (DCFTA) with the Union. Those chapters are expected to be signed and come into force by November, 2014. The benefit of Ukraine from these preferences is estimated at EUR 497 m in annual terms, including EUR 340 m from export of agricultural products.
- ***Sectoral trends.*** Industrial output in March declined by 6.8% yoy. Manufacturing output dropped by 8.1% yoy due to weak domestic and external demand. Production of metallurgy contracted by 11.1% yoy from low statistical base primarily due to decline in exports to Russia. Machine building output declined by 17.4% yoy primarily due to the protracted and significant drop in production of locomotives and railway carriages (by 57.7% yoy) due to lower demand from Russia. At the same time, manufacture of vehicles increased by 34.9% yoy from low statistical base likely due to recycling fee introduced in September 2013. Decline in chemical production decelerated to 2.8% yoy from 5.9% yoy a month before likely due to higher price competitiveness against the background of hryvnia depreciation. Agricultural production in March grew by 5.6% yoy primarily due to higher production of meat and eggs. Drop in construction decelerated to 5% yoy in March from 9.4% in February primarily due to statistical base effect. Between January and March retail trade turnover growth decelerated to 7.7% yoy likely due to slower increase in households' consumption. Moreover, retail sales of enterprises in March grew by only 0.5% yoy.

- **Energy. *Reverse gas flows.*** In April, the Naftogaz started receiving gas from Poland under the contract with German RWE, under which Ukraine is expected to get daily 4.08 m of cubic meters of gas. Total annual capacity of this route is 1.5 bcm of gas. The Ukrtransgaz offered Slovak Eustream to sign an agreement on uniting the gas transportation systems of Ukraine and Slovakia. So far Slovakia only agreed to unite the gas systems on the Vojany- Uzhgorod line. On April 28, the Ukrtransgaz and Eustream signed a memorandum on reverse gas supplies from Slovakia to Ukraine. Ukraine expects to receive annually 8 bcm of gas via this route. The supplies may start in August this year. Ukraine's efforts to diversify gas supply sources should help it to negotiate a new gas contract with the Gasprom.
- ***Conflict with Gasprom.*** Russian Gasprom claimed that Ukrainian Naftogaz owes it USD 18.5bn for not meeting the "take or pay" condition of the contract. Under the contract, the Naftogaz was obliged to purchase 41.6 bcm of gas but it purchased only 12.9 bcm in 2013. The Ukrainian Energy Minister noticed that Naftogaz asked Gasprom in advance to change the volumes of gas to be purchased but received no reply. Ukraine considers going into court about the debt under "take or pay" clause. According to the Ukrtransgaz data, Ukraine imported 25.84 bcm of gas in 2013 including direct purchase of 12.92 bcm by Ostchem Group. Moreover, the details of the "take or pay" mechanism are not specified in the contract. Therefore, Ukraine has high chances to win its case against the Gasprom. The Naftogaz has already sent Gasprom pre-arbitrage note giving it 30 days to reach an agreement. Meanwhile, Naftogaz's debt before Gasprom for gas received continues to grow as the Ukrainian company did not pay for the gas consumed in April. The Energy Minister explained the situation by uncertainty with the price of gas after the Gazprom increased it to USD 485 per thousand cubic meters with which Ukraine disagrees. As of April 1, the amount of gas debt reached USD 2.2bn (based on the price of gas of USD 268.5), the exact amount is being debated.
- ***Tariffs.*** Ukrainian energy regulator the National Energy Regulation Committee increased the marginal price of gas for industrial consumers and budget entities by 17.5% to UAH 4724 per thousand cubic meters starting May 1 due to hryvnya depreciation. This is the second increase in gas price this year.

Ukraine: Economic Indicators 2011 - 2014

		2011	2012	2013	Dec	Jan	Feb	Mar	Apr
GDP (real)	% yoy	5.2	0.3	0.0					
Industrial production (real)	% yoy cum.	7.3	-0.5	-4.7	-4.7	-5.0	-4.2	-5.0	
Agricultural prod. (real)	% yoy cum.	17.5	-4.5	13.7	13.7	6.0	6.3	6.0	
CPI	% yoy eop	4.6	-0.2	0.5	0.5	0.5	1.2	3.4	6.9
Current account	% GDP. cum.	-5.7	-8.1	-9.0					
Fiscal balance	% GDP	-1.8	-3.6	-4.4					
External state debt (total)	% GDP eop	22.8	22.0	20.6					
Gross international reserves	USD bn eop	31.8	24.5	20.4	20.4	17.8	15.5	15.1	14.2
Exchange rate (official)	EUR aop	11.09	10.27	10.61	10.94	10.92	11.80	13.69	16.08

Source: IER.

For further information: Institute for Economic Research and Policy Consulting (link: http://www.ier.com.ua).

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