



DIGEST

**Of Ukraine's Economic Situation and reforms
October 2011**

Ukraine continues to make progress in the implementation of its reform agenda aiming to improve the quality of the business climate in the country

- Vote by the European Parliament for a resolution on Ukraine in October is an evidence of its support for Ukraine's aspirations for EU membership.
- An agreement on free trade area with the CIS countries, as well as the formation of a free trade area with the EU in the future are parts of a single plan aimed at opening foreign markets to Ukraine, Prime Minister Mykola Azarov said in October.
- The Parliament will discuss allowing investors to include leasing and concession payments as expenditures, which should ensure increasing the investment attractiveness of concession objects.
- The State Registration Service is to be created in Ukraine to regulate the state registration of the right to real estate. A resolution on introduction of the Ukrainian State Registration Service drawn up by the Justice Ministry was adopted at a sitting of the Cabinet of Ministers in October. The adopted resolution regulates the procedure for the introduction of the state register of rights to real estate, which will be implemented by the newly created Ukrainian State Registration Service and structural territorial bodies of the Justice Ministry.
- In November, the Cabinet of Ministers will examine regional preparations for introduction of a "single window" for entrepreneurs as of January 1, 2012, Prime Minister Mykola Azarov stated on October 26. Prime Minister said that the government had enough will to finalize plan on the deregulation of the economy and the creation of incentives for business development
- The Cabinet of Ministries estimates that introduction of the procedure for preliminary inspection of documents at the checkpoints on the Ukrainian border from December 5, 2011, will cut down time expense for document inspections by 30%.
- The Ukrainian government has regulated the provision of state financial aid to credit and financial institutions by empowering the Expert and Analytical Council for State's Participation in the Capitalization of Banks to consider relevant proposals from the Finance Ministry. The procedure is stipulated in the Cabinet resolution No. 1066. According to the document, a final decision on the provision of state aid is made by the government. A bank, to which the assets or liabilities of a financial institution with temporary administration are transferred, including a bank for bad assets, can obtain state aid. State aid can be provided using funds from the national budget or through a transfer of government bonds. A bank that receives state aid has to have carried out banking operations at least for two years; it is to be a member of the Individuals' Deposits Guarantee Fund, meet economic requirements set by the National Bank of Ukraine and fulfil its liabilities to clients on time.

- The Parliament, with 264 votes in favour amended the Tax Code and some Ukrainian laws regarding single taxation system reducing tax rates and increasing the turnover limit for all categories of single taxpayers. The law amends section 14 of the Tax Code stipulating that representatives of small and medium business of four groups can pay taxes under the single taxation system. The first group includes businessmen with commodities turnover of under UAH 150,000 per month, who cannot hire employees and who pay a single tax of from UAH 10 to UAH 100 per month – businessmen working on markets and in the household service sphere. The second group includes representatives of small and medium businesses with turnover up to UAH 1 million per month, who can hire up to ten employees and pay from UAH 20 to UAH 200 in single tax, depending on local council's decisions. The third group is a group of individuals with turnover of up to UAH 3 million per months with the right to hire up to 20 employees and who pay single tax of 3% with VAT or 5% without VAT. The fourth group consists of companies with an annual turnover of up to UAH 5 million, with the right to hire up to 50 employees and who pay a 3% single tax with VAT or 5% without VAT. These changes imply an increase of the turnover limit for all groups of businessmen from two to six times, and the sum of tax is halved compared to the present rates. The law gives a chance to single taxpayers to include expenses on the purchase of goods and services from single taxpayers in their gross expenses. The law takes effect from January 1, 2012.
- Ukrainian President Viktor Yanukovich signed a law on the regulation of relations between creditors and consumers of financial services, which introduced a ban on the provision of consumer loans in foreign currency. The Verkhovna Rada passed the law with presidential amendments on September 22. The document also contains a number of important provisions concerning the protection of creditors' rights, the improvement of bankruptcy procedures, and procedures for the sale of claims under credit agreements.

Real sector performance kept improving in September, underpinned by buoyant consumption and outstanding agricultural harvest.

- Private consumption grew by 14.1% yoy in 2Q 2011, further up from 12.7% yoy as compared with a previous quarter. Retail sales turnover, up by 15.2% yoy over the first 9 months of the year, the same pace of growth as for January-August 2011. The growth in private consumption was supported by a 7.7% yoy growth in real wages (over January-August 2011) and increasing consumer credit, which increased by 26% yoy in August 2011.
- Solid budget financing of large infrastructure projects supported robust investment activity. Thus, in 2Q 2011 investments into fixed assets accelerated to 8.5% yoy, up from 4.5% yoy in the previous quarter. Though the growth in construction activity has moderated in recent months, the sector reported decent growth of 11.4% yoy for January-September 2011.

- According to the Ministry of Agricultural Policy and Food, Ukraine was able to collect more than 53 million tons of cereals. In addition, preliminary data showed the country enjoyed record high harvest of selected vegetables. As a result, agriculture advanced by an outstanding 13.7% yoy over January-September. Outstanding performance of agriculture put additional impulse on food-processing development. In September, manufacturing of food and beverages grew by 6.2% yoy compared to a 3.4% yoy decline in production over the first eight months of the year.
- Slowdown in the rate of the world economic growth put additional pressure on Ukraine's export oriented industries. Thus, growth in metallurgy and chemical industry moderated from 18.7% yoy and 21.4% yoy in August to 7% yoy and 9.4% yoy in September respectively.

State budget deficit stood at UAH 5.2 billion, or 15% of the full-year target, thanks to robust tax revenue growth and thoughtful fiscal policy

- According to the State Treasury of Ukraine, revenues to the state budget grew by 40.7% yoy over January-August 2011.
- Within tax proceeds, corporate profit tax collections surged up by more than 47% yoy over the period. High growth of corporate profit tax collections is due to rising profitability of Ukrainian enterprises
- Thanks to robust domestic demand, high imports and introduction of grain export duties, collections from VAT tax and foreign trade duties went up by nominal 30% yoy (excluding VAT refund arrears in tax collections of 2010) and 27% yoy over January-August respectively
- Overall the state budget expenditures grew by 8.2% yoy in the first eight months of the year. This increase was achieved mainly on account of a moderate growth in social security expenditures (up by 8% in nominal terms).
- Due to high budget revenues, state budget deficit narrowed to UAH 5.2 billion, or less than 15% of full-year target.
- In mid-October, the 2012 state budget law was approved in the first reading, targeting a 1.6% of GDP deficit. This would allow narrowing broad fiscal deficit to 2.5% of GDP, fully in accordance with IMF requirements.
- Given the progress made on IMF loan conditions over the last few months, an IMF mission arrived in Kyiv on October 25th.

The National bank of Ukraine (NBU) follows tight monetary policy to both reduce inflationary pressures and maintain Hryvnia stability.

- In September, consumer price index advanced by a meager 0.1% month-over-month (mom). In annual terms, inflation eased to 5.9%, the lowest level since August 2003. Substantial progress in disinflation was achieved thanks to generous agricultural harvest
- Tighter monetary policy stance also contributed to easing inflationary pressures. Higher reserve requirements, large NBU sterilization operations, foreign capital outflow and Hryvnia deposit withdrawals by population led to some liquidity squeeze in the Ukrainian banking system.
- Persistently high population demand for foreign currency and certain worsening of the current and financial account balances of Ukraine's Balance of Payments prompted the NBU to heavily intervene in the forex market. In September, net purchases of foreign currency amounted to \$2.1 billion.
- To support Hryvnia exchange rate, the NBU sold about \$2 billion of its gross international reserves. The decline in reserves was even deeper due to negative valuation effects (depreciation of Euro with respect to US Dollar). As a result, gross international reserves fell by 8.5% to less than \$35 billion at end-September

In September, current account kept widening on faster imports growth than exports. In addition, financial account switched into deficit amid larger capital outflow from the banking system and high population demand for foreign currency.

- The overall rate of growth in exports of goods decelerated from 36.1% yoy in August to 27% yoy in September as metallurgical products are the biggest commodity group in the structure of goods exports (34.5%) post significant deceleration.
- On the import side, the growth of energy resources imports, which account for 34% of total imports, accelerated to 31.3% yoy in September, up from 20% yoy a months before. overall imports growth moderated to 31% yoy from 33.7% yoy in August.