

UKRAINE

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Real GDP growth in Ukraine slowed to 4.1% in 2002 from 9.1% in 2001. Industrial output grew by 7%. Consumer prices fell 0.6% in the year. Growth was 2.3% in the extractive industry, with growth up 8.2% for metallic ores and 2% for hydrocarbons, but down 1.2% for coal and peat. Manufacturing industry output grew by 8.9%, with metals and metals processing growing by 3.9%, ferrous metallurgy by 4%, 1.9% for pipes, 1.3% for primary steel processing, 1% for nonferrous metals and 8.6% for metal processing.

Foreign direct investment increased by 15.2% or US\$783.7 million. Total FDI in Ukraine as at January 1, 2003 had reached US\$5.339 billion, or US\$111 *per capita*. The main forms of investment were cash contributions totalling US\$491.5 million (45.7% of investment) and contributions in the form of property and real estate totalling US\$373.2 million (34.7%).

About 200 million hryvna will be needed to mothball excess and inefficient production capacity in Ukraine's mining and metallurgy sector. Mothballing of production capacity will get under way after parliament passes the National Programme for the Development of the Mining and Metallurgy Sector to 2010. The sector did not fully utilise capacity in 2002. In the iron and steel sector, 92.5% of capacity was utilised in agglomerate production (87.6% in 2001), 61.6% in pig iron production (58.9%), 82.5% for steel (78.9%), 76.2% for general roll (73.8%), 90% for coke (90.4%) and just 38.5% for pipe (42.4%). The Ukrainian metals industry is plagued by structural problems and a technology lag. For example, almost 50% of steel is produced in open-hearth furnaces, and just 19% is produced using continuous casting technology. Core production assets are becoming obsolete and depreciation exceeds 65%. Half of all metal products are made by equipment that has outlived its service life. Per unit expenditure of fuel equivalent is 750 kg/t for pig iron, while in advanced Western countries it is 250-270 kg/t.

Ukraine's domestic market for some metal products is gradually losing momentum and this is keeping metallurgical enterprises oriented towards exporting their products. The consumption of rolled metal in Ukraine in 2002, for example, was only 350,000 t more than in 2001 and totalled 4.54 Mt. At the same time, however, the pace of development of the domestic market for rolled metal products grew by 8.2%. In 2002, most of Ukraine's metals exports were base metals (39.4%).

Iron and steel

Based on the Ukrainian calculation method, Ukraine's iron ore reserves are estimated at around 30,000 Mt, sufficient to maintain mining for hundreds of years at current production rates. They rank second among the former USSR republics in terms of size, behind Russia. The ores have a relatively high iron

content of 45%-55%. The biggest iron ore basin is Krivoi Rog in Dnepropetrovsk region, where the bulk of the reserves (as well as key iron-ore production capacities) are located. Krivoi Rog's mining and beneficiation plants provide around 80-90% of all Ukraine's iron ore, concentrate and pellet production.

Production of iron ore products grew 7.8% year-on-year to 58.94 Mt, including 44.66 Mt of concentrate. Agglomerate output fell by 4.7%, to 10.34 Mt, and pellet output increased by 21.9%, to 13.47 Mt.

Mining companies represented by the state-owned umbrella organisation Ukrudprom produced 20.45 Mt of iron ore concentrate in 2002, 13% more than in 2001. They also produced 7.43 Mt of iron ore pellets, an increase of 1%. The mines produced 40.2 Mt of crude ore, up 6%, including 9.0 Mt from deep mining, an increase of 6%. Iron ore supplied to Ukrainian steel mills increased by 12.5%, to 32.3 Mt. Exports showed little change, at around 11.6 Mt.

Ukrudprom holds large blocks of shares in Severny, Sukhaya Balka, Yuzhny and Inguletsky joint stock companies, all iron-ore producers, and all of the shares in the Komsomolsk, Balaklava and Novotroitsk limestone quarries and the Dokuchayevsk flux and dolomite works. The State Property Fund owns all of the shares in Ukrudprom. The property fund has entered Ukrudprom on a list of 22 major companies in which shares can be sold during 2003. The fund plans to offer 50% of the shares in Ukrudprom.

Ukraine's largest iron-ore producers increased production and sales of their core products in 2002. Inguletsky GOK, the country's biggest iron-ore producer, increased output of iron ore concentrate by 19.7% to 12.45 Mt, and increased sales by 11.4%. Exports comprised 5.6% of sales. The second-biggest producer, Severny GOK, produced 7.06 Mt of concentrate and 5.55 Mt of pellets, respectively 7.6% more and 1.8% less than in 2001. Sales grew by 5.8%, and 15.8% of these sales were exported.

Yuzhny GOK and Tsentralny GOK both posted lower output and sales. Yuzhny reduced concentrate production by 8.1%, to 7.63 Mt, and agglomerate output by 14.2%, to 3.87 Mt. Sales slumped 9.5%, with exports contributing 17.8% of total sales. Tsentralny decreased concentrate production by 3.1%, to 4.12 Mt, but increased pellet output by 11.4%, to 1.88 Mt. Sales fell 4.5%; exports comprised 58.1%.

The Krivoi Rog State Iron Ore Combine increased production of iron ore commodities by 8.1% to 6.05 Mt, sales were down by 11.6%, exporting 61.5%. Sukhaya Balka increased iron-ore output by 1.1%, to 2.94 Mt, but sales fell by 3.4%. Exports accounting for 57% of sales.

In total, Ukraine exported 18.72 Mt of iron ore products in 2002, 3.4% more than in 2001. The country exported 6.24 Mt of pellets, 5.22 Mt of concentrate and 7.07 Mt of agglomerate, respectively 15.9% more, 8% less and 3.3% more. Nearly all the exports were to countries outside the CIS.

Ukrainian iron and steel companies produced 26.4 Mt of finished rolled products in 2002, 4% more than in 2001. Production increased 3% to 30.20 Mt of general rolled products, by 3% to 34.05 Mt of raw steel, and by 5% to 27.60 Mt of pig iron. However, output was down by 8.4%, to 1.05 Mt for pipe, by 4% to 273,800 t for metal products, by 4% to 18.50 Mt for coke (6% moisture), and by 11.2% to 716,800 t for refractories.

In early March 2003, the Ukrainian Metallurgical Corp. joint stock company signed an initial agreement with a group of foreign firms and banks in line with a concept of completion of the Kryvyi Rih oxidised ore mining and processing enterprise (KOOMPE) it had developed. The agreement says that during the first phase up to 2006, the investors will allocate over US\$300 million for changes in production activity of the KOOMPE. The ultimate volume of investments will be determined in a business plan. The potential investors have agreed to pay off H18 million worth of the enterprise's debts for electricity and pay off wage arrears exceeding H5 million. Also, in accordance with a draft law, which has been passed by parliament at the first reading, the investors will undertake to pay off US\$1 billion within 20 years to Romania and Slovakia for their participation in the construction of the enterprise. The construction of KOOMPE started in 1985. It was inherited by Ukraine after the collapse of the Soviet Union. Ukraine's share in the project is 56.4%, Romania has 28%, with the remainder belonging to Slovakia. The estimated cost of construction is US\$2.4 billion of which US\$1.65 billion has already been expended.

Manganese and ferroalloys

Ukraine is one of the biggest manganese ore producers in the CIS. Last year, it produced 2.74 Mt of manganese ore, up 1.3% from 2001. Output of high-grade ore was 767,700 t, up 6.4%.

The two principal producers Odrzhonikidzevsky GOK and Marganetsky GOK closed the year with varying results. The former reduced production of manganese concentrate by 2.3% to 1.66 Mt, and its sales were down by 1.5%. All ore is mined by open pit.

Marganetsky increased production of manganese concentrate by 7.4% to 1.08 Mt and boosted sales by 19.4%. Marganetsky is the only enterprise in the CIS to mine manganese by underground methods. It produces 80% of its ore at deep mines and 20% at open pits. By 2010, it aims to be producing 2.95 Mt/y of concentrate, of which 1.7 Mt will come from underground. The GOK mines the eastern (Grushevsko-Basansky) section of the Nikopolskoye manganese ore field. Privatbank owns 23.6% of the shares, Varkidge Ltd 10.4%, Blumberg of the US 25%, the Cyprus-registered companies St John Trading and Ulrich Ltd own 9.5% and 8.5% respectively, Oksidental Ltd 8.2% and Rafels Ltd of the UK 9.5%.

Zaporizhiya Ferroalloy Works produced 407,000 t of ferroalloys in 2002, 0.7% less than in 2001. It is planned to channel around US\$30 million - US\$40 million into the final, fourth, phase of major reconstruction during 2003-04. The renovation will make it possible to enlarge the range of products and

improve sales. The works is one of the three Ukrainian ferroalloys producers and has a monopoly of ferrosilicon (47.7% of the Ukrainian market), and the sole producer of 80% medium-carbon ferromanganese (100%) and also produces 90% manganese metal. Galaxy Continental Corp. was the owner of 10% of the stock in mid-May 2002, Alsira Investment Ltd owned 12.36%, and Fieldstar Inc., 19.13%. Meanwhile, in July 2002 the Metallurhiya Consortium sold 48% of the shares in Zaporizhiya Ferroalloy Works to an undisclosed buyer.

The Nikopol ferroalloys plant in Dnipropetrovsk region, Ukraine's largest producer of ferroalloys, reduced output of silicomanganese to 593,400 t in 2002, down 4.9% year-on-year. Output fell due to a general deterioration on the ferroalloy market. The works exported 46.8% of its products. The sales were down in Russia by 37%, to 143,000 t. Output of ferromanganese grew by 6.7% to 184,500 t. Overall sales by Nikopol were down by 10.6%.

In 2003, the works is targeting 750,000 t of ferroalloys. The controlling 50% stake in the plant is owned by the government, but managed by bank Kredit-Dnibr. Inter-regional Stock Union owns 33.44% of the shares, and PrivatBank of Donetsk is a nominal holder of 13%. The Ukrainian Government plans offer 25% of the Nikopol Ferroalloy Works up for sale.

The Stakhanov works, which specialises in ferrosilicon, is Ukraine's third-biggest ferroalloy producer. The works increased ferrosilicon production by 9.2% in 2002 to 202,000 t. Like Nikopol and Zaporozhye, Stakhanov is part of the Ukrainian Ferroalloys Association. Wallis Investments Ltd of the British Virgin Islands owns 15.8% of the shares, Midow International Group, also of the British Virgin Islands, owns 24.9%, Ukraine's Metallurhiya consortium (Zaporozhye) 13.19% and Tanner International Group (Bahamas) 16.93%.

Coal

Ukraine, is one of the biggest coal producers in the CIS. In 2002, coal output declined by 3.8% to 59.36 Mt from 61.88 Mt.

Budgetary financing of Ukraine's coal industry and miners' social security, as envisaged in the 2003 national budget will reach H2.95 billion, which is H700 million higher than the actual funding in 2002. The bulk, H2.77 billion, will be directed towards the support and development of the coal sector. The main administrator is the Energy Ministry and the primary objective of the financing is to implement a programme of government support for the construction and retooling of the coal, lignite and peat enterprises. This will cost a total of H1.1 billion, or H403 million more than in 2002.

In addition, the obligatory state social insurance fund must provide H107.4 million to create new jobs for miners at pits which are closing, and H73 million must be earmarked for the payment of late regresses and lumpsum benefits in disability cases. A sum of H830 million will go towards the cost of coal companies' products. The other two budget programmes for the coal industry will be funded at the 2002 level - H75 million for rescue operations and H80 million for safety and accident prevention.

The government plans to form 21 open joint-stock companies in the coal sector that will subsequently be privatised. There are also plans to form seven production associations for mining coal and more than 200 enterprises to replace the current 18 holding companies in the sector. Specialists believe that this will make it possible to improve significantly the utilisation of labour, material and financial resources, attract non-government investment to the coal sector and thus reduce the dependence on budget funding. Thereafter, a unified, national joint-stock company could be set up that would manage stock in government-owned companies.

Meanwhile, Ukraine's Fuel and Energy Ministry is reorganising the production association PO Volynugol and the state holding company Alexandriaugol, with the aim of streamlining the organisational and legal structure of the country's coal companies. A state company, Volynugol (Novovolynsk), will be created on the basis of PO Volynugol, and state-owned mines Shakhta No. 5 Novovolynskaya, Shakhta No. 1 Novovolynskaya, Shakhta No. 9 Novovolynskaya, Shakhta Buzhanskaya and Volynuglesbytpostacha. The Novovolynsk Repair-Mechanical Plant will be spun off from PO Volynugol. The open joint-stock Alexandriaugol (Kirovohrad region) will be created on the basis of the eponymous holding company, and state companies Alexandriiskaya Avtobaza, Alexandriauglesbyt, Trest Alexandriarazrezstroi, the communications centre, the well drilling division, and the computer centre.

The ministry has announced plans to reorganize Lisichanskugol, Pervomaiskugol, Luhanskugol, Rovenkiantratsit, Krasnodonugol and Donbassantratsit in Luhansk region into open joint-stock companies. In the Donetsk region, the ministry is considering merging Donugol and Donetskugol. The ministry is also considering creating a vertically integrated - company based on Lvivugol, Volynugol, Zakhidenergo and Lvivsistemenergo.

Ukraine's leading coal sector institutes, Dongiprouglemash, MakNII and DonUGI, have developed a programme for the accelerated replacement of equipment at 70 promising coal mines in 2003-04. The programme would boost coal production in Ukraine by 3.5 Mt/y and reduce costs by 5% to 15%. The programme calls for supplying modern mining equipment to 72 mine faces.

Aluminium

Ukraine's Nikolayev Alumina Plant (NGZ), the biggest alumina producer in the CIS, produced 1.13 Mt of alumina in 2002, 1% more than in 2001. NGZ has a seaport, capacity of 5 Mt/y, a power plant and a rail terminal with a capacity of more than 2 Mt/y. Ukrainian Aluminum Ltd, subsidiary of RusAl, owns 29.99% of NGZ's shares and Galinton Associated Ltd, 10%. Nominal holders, ING Bank Ukraine and the Bank Austria Creditanstalt Ukraine were registered to have 27.80% and 27.79% respectively. The final 10% state-owned shareholding was bought by Ukrsocbank late in March 2002. The remainder are held by minor shareholders.

NGZ had embarked on a set of upgrades that were intended to increase capacity from 1 Mt to 1.3 Mt/y of alumina by the end of 2002. However, in

April 2002 the Ukrainian Government granted a request by RusAl, which controls nearly 30% of the shares in NGZ, to let it have another two years to increase the capacity and to fulfill the terms of an investment tender for the shares.

The Zaporizhia aluminum mill (ZaIK), Ukraine's sole primary aluminum producer, managed to boost its output by 6% in 2002, to 112,459 t. In addition, the mill produced 224,900 t of alumina. ZAİK's facilities are designed to produce around 100,000 t/y of primary aluminum. The entity launched a line to manufacture roll casting for aluminum foil, with an annual capacity of 16,000 t. The Russian JSC, AutoVAZ-Invest, holds 68.01% of ZaİK's stock, the state 25%, with the remainder split among various legal entities and individuals. In October 2002, the supervisory board at ZaİK approved plans to issue H30 million, or US\$7 million, in local-currency bonds. Russia's Avtovaz-Invest owns 68.01% of the shares, and the state 25%.

Since December 2002, Ukrainian Aluminium (UkrAl), a subsidiary of RusAl, has begun building an aluminum smelter in Ukraine to comply with obligations assumed when it bought a 30% stake in NGZ. The new smelter in Pervomaïsk, Kharkiv region will cost more than US\$300 million. Ukrainian Aluminium Smelter Co. will manage the project, and Zaporizhzhya Institute Titan has been selected to design the facility. The contractor for construction will be Ukrmontazhspetsstroi, which was selected in an internal tender. The actual construction of the smelter will be carried out by this company's regional division Kharkivmontazhspetsstroi. UkrAl has assumed the investment obligation to build a smelter with capacity of 120,000 to 180,000 t/y of primary aluminum. UkrSibbank, one of UkrAl's shareholders, has said it would help finance the project.

Oil and gas

Ukraine produced 18.442 billion m³ of gas in 2002, 1.3% more than the 18.2 bcm it achieved in 2001. Production of oil with gas condensate fell 2.2% from 3.7 Mt to 3.6 Mt.

The Ukrainian Ministry of Fuel and Energy is working to create a vertically-integrated oil company for extraction and refining of Ukrainian oil on the basis of state-owned stocks of oil extraction and oil refining companies. It was suggested that this vertically-integrated company be established on the basis of state-owned interests in Ukraine's oil extraction monopoly, JSC Ukrnafta, JSC Ukrtatnafta (Kremenchuk oil refinery), JSC Naftokhimik Prykarpattia (Nadvyrniansky oil refinery), and the Scientific Production Enterprise Halychyna (Drohobych oil refinery). According to the authors of the idea, creation of a new company will allow improved profitability of state assets. The state owns 51% of Ukrnafta, 26% of Naftokhimik Prykarpattia, 55% of Halychyna, and 43% of Ukrtatnafta. Ukrnafta extracts about 3 Mt/y of oil, whereas the market demand is about 19.5 Mt.

Other minerals

State company Ukrpolimetally (Ukrainian Polimetals) closed 2002 with pretax profits on core activities up 78%, to US\$10.7 million. The company increased

production of all its main products, including titanium and zirconium concentrates, cut diamonds, jewelry and amber. Exports accounted for 65.3% of total sales compared with 51.4% in 2001. The company's mining and milling subsidiaries include Volnogorsky GOK, Irshansky GOK and Burshtynovi Kopalni (an amber mine), among others. Ukrpolimetal also has subsidiaries in the diamond business (Izumrud of Kyiv, Kristall in Vynnitsia and Rokitnoye-Smaragd), and the jewelry industry (Lviv State Jewelry Factory, the jewelry division of Kristall, Burshtyn and Ukrburshtyn).

Ukrpolimetal produced 18 kg of gold in 2002 against 69.2 kg in 2001. Production fell owing to the suspension of operations of the concentrator in September of 2001 when ore for the first stage of the mine was exhausted. The company continued with construction of the second stage of the mine and modernisation of the concentrator. At the same time, Ukrpolimetal is carrying out promising negotiations for private sector investment in prospecting and the development of goldfields. Experts estimate that Ukraine has a resource base sufficient to produce 3,200 t of gold.

Volnogorsk State Mining and Metallurgical Combine, a producer of zirconium and rutile concentrates from Ukraine's Dnipropetrovsk region, produced 62,400 t of rutile concentrate in 2002, 2.7% more than in 2001. Figures were also up for zirconium concentrate, by 2%, to 34,300 t, and for ilmenite concentrate, by 6.6%, to 191,100 t. The combine exported 80% of production, to other CIS countries, the US, Italy, Germany, Bulgaria, Poland and Romania. Barter sales did not exceed 1.3%. The company's finances are gradually improving as the combine restores metallurgical production of silicon tetrachloride and zirconium dioxide, as well as the launch of a new high-quality product division. The combine accounts for half of the zirconium concentrate produced in the CIS and Europe and is the only producer there of zirconium and rutile concentrates. The combine is on a list of enterprises that cannot be privatised.