Focus
Ukraine

Scope
Economics

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Quarterly Report

Trapped in “The Depression Union"

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READ FIRST THE DISCLOSURES SECTION FOR IMPORTANT DISCLOSURES AND ANALYST CERTIFICATION

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Executive summary

This is an updated and condensed summary of our macro view for the next three-year period of 2015-17.

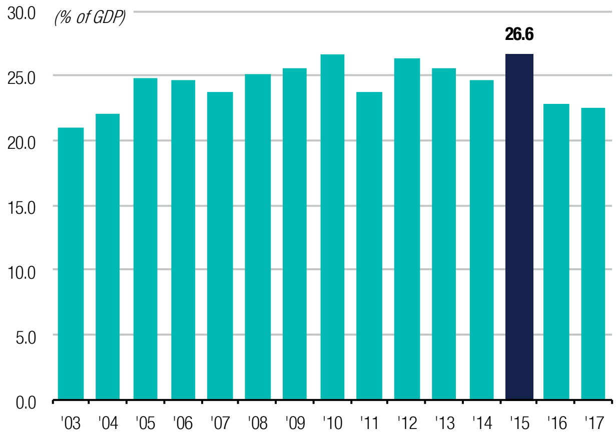
Economics vs. geopolitics: "The Ukrainian crisis" should really be named "The Russian economic crisis". The main underlying factor behind the Kremlin's aggression towards Ukraine has been the Russian economy, which fell into stagnation in 2012. After three years of sliding real GDP growth in Russia, this year an outright contraction of 3-5% for the full year is widely acknowledged (versus our forecast of a 5% contraction). A Russian leadership crisis emerged in 2012-13 when Putin's approval index collapsed and hovered at an all-time low from the beginning to the end of 2013. Also, 2013 should be also remembered as the year when the Kremlin launched a beggar-thy-neighbour policy with a high stakes use of resources when it masked the policy to convince neighbouring countries to join its Customs Union. In 2014, Putin's approval index rebounded as Russian nationalism was ignited by the annexation of Crimea and ongoing 'New Russia' operations, basically a war on Ukraine, in the face of a sharp devaluation of the ruble and accelerated inflation. Moreover, based on developments in 2014, Russian Finance Minister Siluanov proclaimed that the "Dutch disease is over" on 6 February 2015. The Kremlin used overhyped militarism and geopolitical adventurism to mask its severe domestic economic problems, consolidate its citizenry against external foes, and switch to a new economic model based on the competitive exchange rate and domestic demand skewed toward domestic products. For more details, please refer to "Russian recessionary economy: An epicentre of negative spillovers" on p.22.

Global economy: A strong US dollar prospect is still a challenge. The US dollar experienced the strongest rally in its history from July 2014 through February 2015, which had a deflationary impact on commodity prices in 2H14. The dollar surged because of the US economy's visible strength (fast real GDP growth in 2Q-3Q of 2014 and declining unemployment), the Eurozone's woes (stagnation followed by an ECB QE program), and the stagnation of China's export-oriented industrial sector. In our view, since this February through the summer, financial markets should reverse albeit with mediocrity, i.e. the US dollar should flatten and commodity prices should rebound slightly. In the summer, the US dollar should resume its appreciation and commodity prices should retouch 12-month lows. Hence, in our base-case forecast, we see steel prices stagnating and the crude oil price staying below US$60/bbl in 2015-16 (see Table 5, p.29). A more profound impact of the global story of a stronger US dollar is being felt in Ukraine's economy via its external financial account, where private sector deleveraging and capital flight from local currency into US currency has been very profound in 2H14 and early 2015. In our view, this trend should moderate before it accelerates again on the back of a likely renewed US dollar rally in 2H15 when the US Fed is expected to start raising interest rates. The above-mentioned Russian crisis is also prone to the challenging prospects of a strong US dollar.

Ukraine's economy: Trapped in "The Depression Union". What is most ironic about the Kremlin-promoted (Eurasian) Customs Union was that the Kremlin, in fact, was laying ground for a "Depression Union" instead. The Russian economy's imminent recession pushed most of the neighbouring countries to adjust abruptly through devaluations and into recessions. In Ukraine, this development was compounded by a hybrid war waged by the Kremlin. Now, because of the lengthening impact of the Russian crisis on the Ukraine's economy, which is seen through the prism of the failed Minsk 2 agreement (see "Minsk 2: Macroeconomic background", p.12), and because of the destruction of the domestic banking credit market, the recessionary trend in Ukraine's economy could deepen and prolong. Thus, our base-case scenario envisages a 7.6% contraction in 2015 followed by zero growth in 2016 and a 2.6% recovery in 2017. While nominal GDP is expected to increase to UAH1,903bn in 2015, up from UAH1,1551bn in 2014, the economy's size in the US dollars is forecast to contract more than two-fold from US$130bn in 2014 to US$63bn (because of the hryvnia's devaluation), the lowest level since 2004. In 2016-17, as measured in US dollars, the economy should recover to US$77bn and US$92bn, respectively.

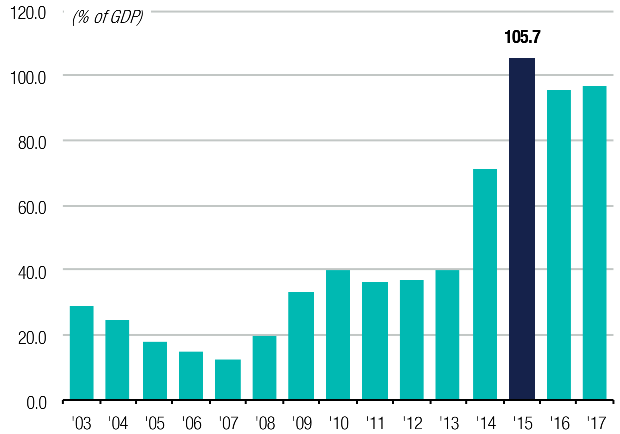
Public finances: Debt level to spike again in 2015, urging fiscal consolidation by 2016. The above-mentioned misery of Ukraine's economy implies irrefutable fiscal strain. The central government's budget deficit is projected at 7.5%, which, combined with taxpayer support of Naftogaz, bank recapitalizations, and the severe currency devaluation through early 2015, should push public debt toward 123% of GDP. The debt level is projected to subside back toward 100% in the following years on the back of a projected fiscal consolidation as debt becomes burdensome and the currency rebounds in real trade-weighted terms from its extreme lows of 1Q15 (Chart 3, p.5). In our view, fiscal consolidation is becoming inevitable in 2016-17 as financing in the inflationary environment becomes politically unbearable. That is why the central government's share of primary expenditures in GDP is forecast to decrease (see Chart 1 below).

Chart 1. Primary expenditures of the central government as share of GDP (% of GDP)



Source: Ministry of Finance, ICU.

Chart 2. Public debt level (% of GDP)
Includes direct and guaranteed public debt



Source: Ministry of Finance, ICU.

External debt restructuring: Worth cutting. In our view, by forcing sovereign Eurobond investors into discussions, Ukraine's government receives a once-a-decade opportunity to renegotiate its steadily deteriorating debt burden. It has a chance to reduce the coupon rate and reduce principal. Our base-case scenario envisages a coupon reduction to 4.5% and principal discount of 50%, which will provide meaningful relief to Ukraine's public finances. For more details, please read "Sovereign debt restructuring: Worth cutting" on p.36.

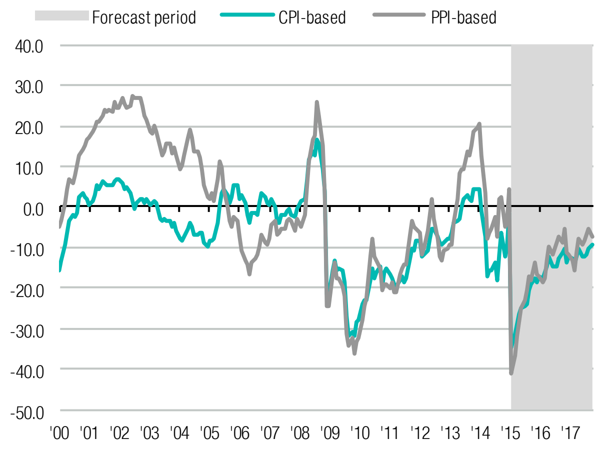
Prices and monetary conditions. Double-digit inflation is expected over the next three years. Average headline CPI in the current year is expected to accelerate to 28.9% YoY from 12.1% in 2014; in 2015-17, it should subside to 18.4% YoY and 15.2% YoY, respectively. While regulated tariffs (natural gas and heating utilities) are set to increase by IMF prescription, authorities are reluctant to make this via an accelerated pace, preferring a slower and less socially painful pace. The same approach is true in the resolution of the banking sector crisis which faces a protracted issue of dealing with impaired loans due to the lengthening and deepening recession. Interest rates are likely to be hiked by the NBU to attract UAH deposits.

External balance: Low FX reserves become routine. In our view, for the external balance, a successful sovereign debt restructuring is less crucial than addressing the domestic issue of total risk aversion. During 2014 (especially in 2H14), the banking and corporate sectors, with large external debt on their balance sheets, substantially increased the pace of external debt deleveraging. As of end-2014, 12-month rolling debt ratios for banks and corporations dropped below 50%. If this trend extends into 1H15, it is unsustainable. Given the ongoing recession and military conflict with Kremlin, authorities are more likely to keep the economy in a tight straitjacket of capital controls, which is already underway. For more details, please read "External balance: In the emergency" on p.39.

UAH: Undergoing protracted distress. In our view, the recent sell-off in the FX market has pushed the Ukrainian hryvnia into deep undervaluation. To prevent a currency freefall, the aurthorities are being accepting tight capital controls to survive 2015-16. The central bank *de-facto* is to pursue a FX regime that limits currency volatility.

Chart 3. UAH's misalignment by real trade-weighted indices

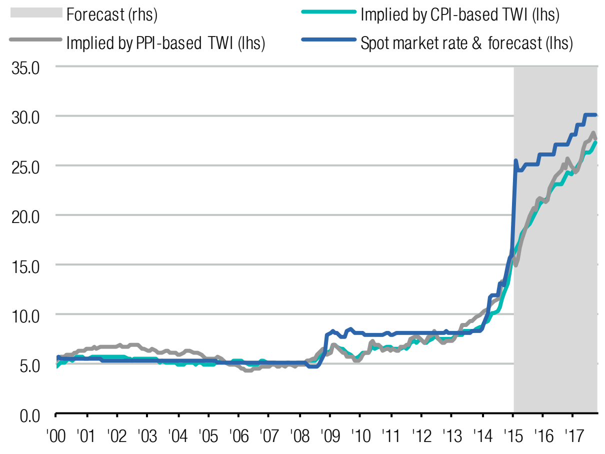
History from January 2000 through January 2015. Forecast for 2015-17



Source: ICU.

Chart 4. UAH's historical nominal exchange rate to the USD

History from January 2000 through January 2015. Forecast for 2015-17



Source: ICU.

Geopolitics

The Kremlin's concentrated aggressiveness towards Ukraine has many known explanations, the lesser known of which stems from macroeconomics. As we have explained in previous reports published over the past year, the Kremlin launched its offensive on Ukraine back in early 2014 in large part because it had entered a protracted economic crisis. It created a "Ukrainian crisis" on two fronts - both a grassroots campaign on the ground in Ukraine and a Russian state-run media propaganda campaign - simply to deflect public attention away from the plethora of impending economic troubles. While it successfully boosted Putin's approval ratings, the Kremlin became caught in a self-made trap. The Russian economy is being crippled by an earthquake-like adjustment arising from cheap crude oil, a massively devalued ruble, burgeoning double-digit inflation, poor economic policymaking and lastly by sanctions. The Kremlin's domestic audience, while feeling the economic pain, only sees a diplomatic solution as a form of defeat. The massive propaganda campaign based upon anti-Western sentiments and conspiracy theories has fomented such attitudes and expectations among the public that a diplomatically reached solution could back-fire on the Kremlin. Hence, a viable path for Ukraine to adapt to such an environment of aggressiveness and insecurity that comes from the eastern border with Russia is a reliance on a combination of financial assistance for the economy and security assistance in the form of deterrence, which includes threats of more sanctions on Russia and the supply of lethal weapons to Ukraine and their gradual implementation.

When macroeconomics crosses the path of geopolitics

The Russian war on Ukraine is a *matryoshka* doll. Inside the big doll (representing geopolitics) are the smaller dolls (representing economics and Putin's hold on the Kremlin).

From the moment the so-called "Ukrainian crisis" was sparked more than a year ago, the Kremlin's geopolitical posturing has been about such noble issues as a multi-polar world and claims over the sphere of its strategic interests. Its key message to the global powers over the past several years is that Russia's strategic interests must be honored. The West's long-lasting humiliation of Russia, as depicted by the Kremlin, has fomented extremism in foreign policy and a kind of revival of the Cold War that threatens wider regional security in Europe. Hence, the widely accepted view is that the Kremlin's objective of the "Ukrainian crisis" is to force the federalization of Ukraine, prevent the possibility of NATO and EU memberships for Ukraine, and eventually install a Kremlin-friendly government in Kyiv. The widely held assumption is that the Kremlin intends to push forward with its aggression in a 'no-matter--what' style and disregard any criticism from the global community.

The Kremlin's war on Ukraine, however, is driven to a large extent by macroeconomic factors. Thanks to the spectacular collapse of the price of crude oil, the Russian economic crisis, which has been developing since late 2012, is well-known. In our previous macro reports[1], we paid attention to the developing economic crisis in Russia. The course of the past year's developments provided evidence that the Kremlin's aggression toward Ukraine could be explained by macroeconomics.

[1] Since October 2013, see http://www.icu.ua/en/research/macroeconomics.

Several explanatory points place macroeconomics ahead of geopolitical concerns here, instead of the widely accepted view that geopolitics (because of sanctions) resulted in poor macroeconomics for Russia.

First, the Russian economy and Putin's approval index have been declining steadily from 2011 and reached a tipping point in 2013 when Putin's approval had plummeted to historic lows and economic growth was about to halt.

Second, the Russian leadership was either unwilling or incompetent to successfully restructure the economy from its chronic dependency on high energy exports. Energy exports provide nearly half of the budget revenues.

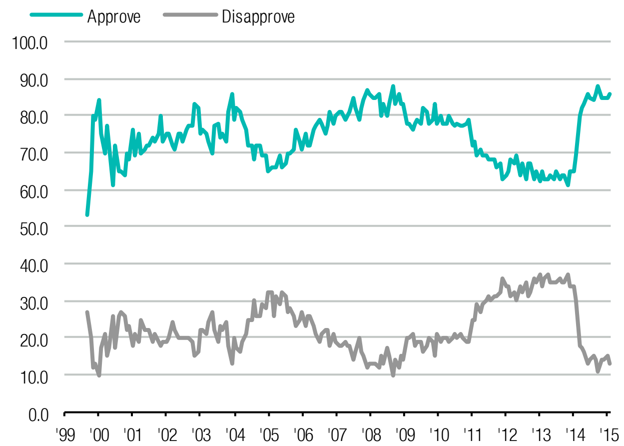
Third, a government-sponsored attempt to foster innovation in the Russian economy failed. Moreover, while the global energy market braced for cheap energy from US shale, Russian state-run energy companies were trying to shrug off the shale threat and effectively stuck in the shadow of a US$250/bbl crude oil talk by Gazprom CEO Miller. Despite his verbal attempts in 2009 to inflate mid- and long-term projections of energy prices, reality hit hard.

With poor economic prospects and a population longing to revive past greatness, the Kremlin fomented its long-lasting efforts of meddling into Ukrainian affairs and created a severe crisis. The state-controlled media and effective death of political opposition resulted in a wide-scale propaganda regime that covered a Russian invasion into Ukraine which resulted in a peaceful annexation of Crimea and an aggressive invasion into Donbas that resulted in 5,000 fatalities.

This strategy proved a success to the Kremlin. Putin's approval ratings retouched historic highs last seen during the war with Georgia in August 2008 (see Chart 5 and Chart 6 on p.7).

Chart 5. Approval of Putin* (%)

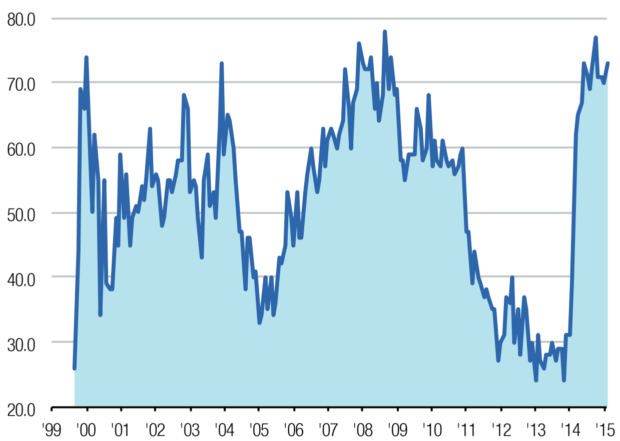
Monthly history from August 1999 through February 2015



Note: * Share of respondents who answer approve/disapprove to the question – do you approve the activities of V. Putin as the President (Prime Minister) of Russia? Source: Levada.

Chart 6. Putin's approval index*

Monthly history from August 1999 through February 2015



Note: * calculated as difference between those who approve and disapprove Putin. Source: Levada, ICU

Is there any end to violent geopolitics?

Wildly anti-Ukrainian and anti-Western propaganda propounded by Russian state-run media generates high approval for the Kremlin among ordinary Russian voters, who reportedly are prepared to support their leader and even volunteer to join the army in Donbas and fight alongside regular troops.

A Russian top government official famously proclaimed in Davos on 23 January that "a Russian will never turn away from their leader[2]" – not only declaring to the world the Kremlin's total political grip of its people, but it was also an implicit call to his citizens to consolidate and support the Kremlin for the lengthy confrontation with the West.

With the above-mentioned support, the Kremlin can both play deadly geopolitics and concurrently manage its macroeconomic adjustment that has been underway since 2013. This macroeconomic adjustment could have been much more politically costly to the Kremlin had no crisis in Ukraine been created by the Russia's special operation forces, regular army, and state-run media.

Hence, the deadly geopolitical tactics underway in Donbas are much more a function of the domestic policies for the Kremlin rather than of foreign policy. Resolving the Ukraine-Russia military stand-off has limited feasibility as the Russian domestic audience prefers anti-Ukrainian and anti-Western propaganda to the extent that the Kremlin must continue to fuel it, making its negotiation power in the diplomatic talks quite limited, i.e. allowing no military scale-back.

By nature, the Kremlin's geopolitical stance has routinely disregarded written agreements. While some EU politicians think that a new agreement with the Kremlin to settle the "Ukrainian crisis" in some way corresponds to the Kremlin's demands to federalize Ukraine and avert any alliances with the West, these politicians are widely mistaken. The Kremlin demands prolonged aggression in Ukraine. If such an agreement were to materialize, the region would become more unstable as Ukraine will fall under a highly repressive and economically depressive political regime.

The Donbas war has escalated over the course of second half of January 2015 with heavy civilian losses.

The Kremlin is generally interested in further economic destabilization of Ukraine. One point of interest is the progress of the pro-Kremlin militants towards Crimea allowing a land corridor for viable living of the annexed peninsula. It is widely understood that in waging war on Ukraine, the Kremlin likes to archive its above-stated goals. While doing this, it would aim to show a willingness to compromise. Thanks to the ongoing economic crisis in the Eurozone and wider EU, the Kremlin has room to maneuver as democratic elections and dissatisfaction with austerity measures bring to power (in Greece recently and likely in other parts of the EU) the fringe parties that confront mainstream political decisions, including the EU's foreign policy of sanctions against Russia. Hence, the Kremlin is in no rush to compromise.

On the other hand, domestic factors would lead the Kremlin's geopolitical posturing to a normal (pre-Crimea) scale. As these domestic factors are macroeconomic in nature, change requires time. So far, it is observed that the Kremlin prefers crisis management over economic development and tries to calm the economic effect of the ongoing macroeconomic transition. Its exchange rate policy that *de-facto* allowed the ruble to devalue massively is currently focused on preservation of the official FX reserves and tighter control on capital flows and domestic prices. There are a number of forced limitations imposed on private businesses (large and small ones), which effectively postpone exchange rate and price adjustments. This is likely to put additional pressure on

[2] See more http://www.weforum.org/sessions/summary/russia-outlook-1

economic activity as businesses, which are not allowed to pass cost increases onto consumers, will likely cut labor. Private sector labor market problems will have spillover effects into the public sector. Already in 2014, there was a media report on a flood of applicants to join the professional army, exceeding the full-year quota which was reached effectively in 3Q. Over some time, this may relieve the Kremlin's efforts to wage war on Ukraine as a larger army will result in more paid volunteering to fight on the ground in Donbas. Albeit a bit later, economic adjustment in the form of shortages of goods and public services would more widely affect the common folk. More Russian casualties in the Ukrainian war would progress and Putin's approval rating could erode rapidly as it did in 2011-12 (see Chart 6 above). In a base-case scenario, this domestic pressure on the Kremlin will materialize after 2016 (50% probability). It would be a best case scenario if it merges this year (5% probability). Our worst-case scenario is that Putin retains high approval ratings (45% probability).

Status of the territories under aggression

The Minsk peace agreement is dead. While diplomacy continues to remain active over the Donbas war, it is more likely to remain effective. Hence, in our view, the Donetsk and Luhansk oblasts that happened to be occupied by pro-Kremlin militants should remain as enclaves that are *de-facto* run by Kremlin. This is our base case scenario (60% probability). Realization of the Minsk peace agreement (with the Russian army and volunteers being pulled back across the border) is our best case scenario (5% probability). An expansion of the area under pro-Kremlin militant control is our worst-case scenario (35% probability).

What assistance must the West provide?

As explained above, there is no diplomatic solution on the horizon for the current geopolitical crisis between Ukraine and Kremlin. As Putin's Russia rejects Ukraine as it is, the only kind of a peace plan that could be reached between the West and the Kremlin over Ukraine would mean the same thing for Ukraine's nation and economy. In this regard, a path that would be tested by trials and errors (i.e. more violence in Ukraine) would lead to a system of deterrence of the Kremlin's aggressiveness towards Ukraine. This system has been shaping already and it would be based upon three actions: (1) imposing increasingly severe economic sanctions on Russia; (2) supplying lethal weapons to Ukraine to defend itself; and (3) committing large and regular financial assistance to Ukraine.

While a sanctions regime has assisted the Kremlin's strategy to blame the West for domestic economic misfortunes and consolidate support around Putin, the evolving economic pain of sanctions that feeds into inflation and restrictions to trade and capital markets does have an impact on Russia's leadership. The threat of additional sanctions on the Russian economy in our view has restrained the Kremlin from pursuing even more aggressive attacks on Ukraine. Even now, the Kremlin avoids wide-scale interventions even though it has been boasting of having heavy munitions in place on the Ukrainian border. Now it is limiting itself to gradual aggression through pro-Kremlin militants that are aided by the Russian army.

In this regard, the possibility of the US and NATO allies providing munitions to Ukraine's army is an option that could fortify Ukraine's defense and deter the Kremlin.

Financial assistance is the last area of deterrence against the Kremlin's aggression. Although the IMF program has been providing funds since 1H14, Russian aggression has undermined any potential foreign assistance to Ukraine. Because of this, external financial assistance is ineffective if it is unaccompanied by the security assistance of economic sanctions on Russia and military assistance to Ukraine.

The latest news from the IMF on the chances of getting external financial assistance is about substituting the previous SBA (Stand-By Arrangement) program with a new EFF (Extended Fund Facility). In our view, this new program could amount to XDR12.4bn or US$17.6bn. This equals the so-called normal access for a borrower as there is a limit of 600% of the country's quota in the Fund. Ukraine's quota is XDR1.4bn. It is less likely that the IMF will grant Ukraine an exceptional access, which is rarely applied and was used only twice in the past several years, namely to assist Portugal and Ireland alongside other donors that provided more financing than the IMF did (see Table 1 on p.10). In Ukraine's case, however, the Fund appears to be the key lender that dwarfs others.

This move effectively means that instead of the previous SBA under which Ukraine could get US$12.6bn, the new one will provide greater funding of US$17.6bn.

Table 1. Examples of most recent EFFs and assessment of the size of Ukraine's EFF

Date of IMF announcement	Country to be rescured	Duration (yrs)	EFF volume (SDRbn)	% of quota	Normal access	Exceptional access	Comment
04.07.2013	Pakistan	3	3.53	N/A	N/A	N/A	
03.04.2013	Cyprus	4*	0.89	563	Y		"...to achieve a 4 percent of GDP primary surplus by 2018"
15.02.2013	Jamaica	4	0.48	175	Y		"... participation of private creditors in the debt exchange"
12.05.2011	Moldova	3	0.37	300	Y		"...support of its external reserve position"
05.05.2011	Portugal	3	24.00	2,300		Y	Total financing package of EUR78bn (about US$116bn)
28.11.2010	Ireland	4	19.50	2,320		Y	Total package from IMF and donors EUR85bn or US$113bn
19.05.2010	Armenia	3	0.27	290	Y		
02.11.2009	Seychelles	3	0.02	225	Y		"...to replace the current SBA"
01.02.2015	**Ukraine**	4	8.23	600	Likely	Not likely	
	Net repayments		4.16				Scheduled repayments under previous SBA
	Total for Ukraine's EFF		**12.39**				

Notes: * On Cyprus there is no explicit indication on the duration of the facility
Sources: IMF, ICU.

The IMF will be a key lender to Ukraine in this transitional period of 2015-17. The table below provides our assessment of what other donors have committed so far to Ukraine. This includes US$2.4bn of funds under the FX swap agreement with China's central bank. Total projected external financing to Ukraine is US$27.9bn. However, it is also assumed that international donors' commitments (excluding those from the IMF) could be delayed due to bureaucratic procedures.

Table 2. Assessment of the external financial assistance for Ukraine in 2015-17

Entity	Volume (US$bn)	Comment
IMF	17.60	IMF's EFF programme
US	2.00	US govt back Eurobonds
EU	3.14	Committed loans of EUR2.8bn
WB	1.50	Likely commitment for 2015
EBRD	1.20	Likely commitment for 2015
China central bank	2.44	FX swap line to be used by NBU
Total	**27.88**	

Sources: ICU.

The weak element of the West's assistance to Ukraine is the EU's economic divide, where crisis-stricken nations vote for political leaders who are unaligned with the EU core political establishment. Several of the fringe political parties, including the National Front in France and the ruling parties in Hungary and Greece, have been forging alliances for economic support from the Kremlin recently.

Russia's option to accelerate bond repayment

There is an infamous GDP covenant in the Russian US$3bn two-year Eurobond, a bailout bond engineered by or for the Yanukovych administration in the final months prior to its abdication. The bond matures this December and has a 60% debt-to-GDP covenant that is vaguely written (Chart 7).

Chart 7. An extract from the Russia Eurobond prospectus

(b) ***Debt Ratio***

So long as the Notes remain outstanding the Issuer shall ensure that the volume of the total state debt and state guaranteed debt should not at any time exceed an amount equal to 60 per cent. of the annual nominal gross domestic product of Ukraine.

Source: Bloomberg.

The debt-to-GDP covenant is not a standard Eurobond inclusion. As this particular covenant in the Russian Eurobond prospectus makes only a general reference to the 60% metric, it does not specify how it is calculated. For example, should the debt-to-GDP ratio calculate everything in local currency or in FX, namely US dollars? A lack of market convention on the debt-to-GDP ratio as described in a number of sources[3] can lead to markedly different results: according to our calculations, the US dollar based ratio for Ukraine at the end of 2014 came in below 60% at 53.2%, while a UAH-based calculation exceeded this level at 70.8% (see Chart 8 below).

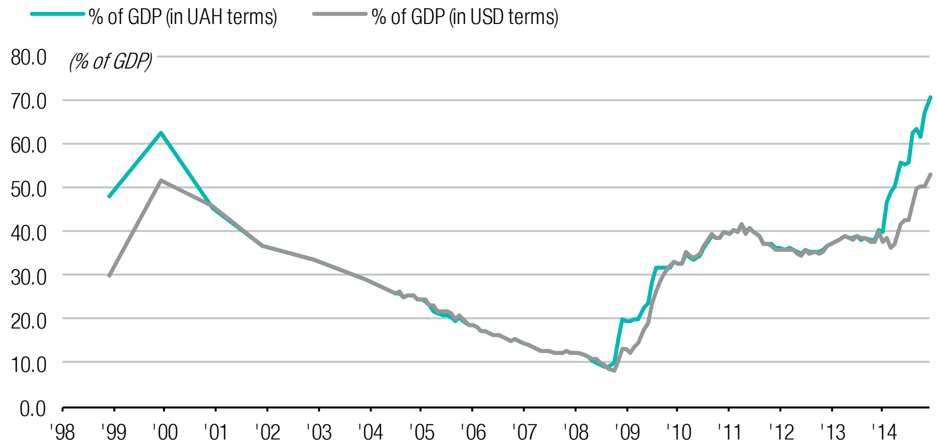
Thus, if Russia were to file a claim for a breach of the covenant occurred in early March[4] and demand redemption prior to its due date of 20 December 2015, Ukrainian authorities could counter that claim and have grounds for denial. We believe that the Kremlin is planning to claim a breach of covenant and demand early repayment not for the sake of the cash flow but rather to undermine (by any means) the Ukraine's financial stability.

[3] Including this one: Sturzenegger, F. and Zettelmeyer, J. (2007), *Debt Defaults and Lessons from a Decade of Crises*, MIT Press.

[4] This is the period for which official statistics on 2015 GDP will be available.

Chart 8. Public debt-to-GDP ratios: UAH-based and USD-based (% of GDP)

History from December 1998 through December 2014



Source: Ministry of Finance of Ukraine, ICU.

Minsk 2: Macroeconomic background

In a second attempt by Ukraine (supported by the West) and the Kremlin to stop the Donbas war, there is a great deal of uncertainty whether the key sides--Ukraine's leadership and the Kremlin--will fulfil the agreement. The details of yesterday's agreement are available at the following sources: *Financial Times* (http://on.ft.com/1CYFpBD) and *Wikipedia* (http://en.wikipedia.org/wiki/Minsk_II).

While the democratically elected leadership of Ukraine has a mandate to align Ukraine with the EU, the Kremlin is on a mission to restore Russia to its former Soviet Union glory as a pre-eminent global power.

Below is our analysis of the macroeconomic factors behind the second Minsk agreement.

Ukraine

The Donbas war has put a sizable drag on Ukraine's economy. Prior to the war, the economy had been in recession since 2Q 2014, and the war just deepened and prolonged the recession. Hence, the longer the threat of war looms, the longer the recession is going to be – possibly over the next two years. In our view, real GDP declined by 6.7% YoY over the past year and could decline another 6% this year. Extreme devaluation and inflation will continue to endanger the economy this year and could worsen. Kiev's prime focus is not war, which costs US$8m/day, but an immediate economic turnaround. Because there is a direct correlation between political approval ratings and economic well-being, we tend to think that Ukraine's call for a ceasefire in the second Minsk talks is genuine.

The Kremlin

Because the Kremlin has been run by *siloviki* since 2000, including mainly the security services people, the rules of the political game here are different than in other places. The Kremlin's statements should not be taken at face value, according to our observations. In addition, the Kremlin's handling of the Russian economy, in our view, has been populist and ultimately ineffective if not serially mismanaged. That said, it does not mean that the Kremlin avoids the advice of prudent macro economists, but instead it has been hiring them to assist the *siloviki* to govern –names like Kudrin, Gref, Ulyukaev, Nabiulina, Yudaeva are well known. Although they are allowed to speak openly and formulate the problems that should be addressed, ultimately the *siloviki* decide via which tools the problems should be addressed.

For example, the Russian ruble's trade-weighted value from 2002 through 1H 2014 steadily appreciated and became extremely overvalued (see the charts below). When the ruble's FX rate was 33/USD on the market as of 1 July 2013, its so-called fair value was 45/USD[5]. In other words, the ruble at 33/USD was a drag on the economy, but at 45/USD the economy could be doing better. Exactly when the ruble was overpriced, Russian officials (of the class of prudent macro economists) occasionally hinted at the danger of inflation and lost competitiveness. At some point, when real GDP growth was flagging and slowing every year since 2010, and the price of crude oil was certain not to survive next year above US$100/bbl, official policy warmed to a such macroeconomic adjustment through currency adjustment that (if done) should make the foundation for real GDP growth more solid.

However, in 2012, when Putin took office as the newly re-elected president, the Russian public was becoming increasingly negative. In January 2013, Moscow-based polling firm Levada registered Putin approval index hitting a historical low of 24 points (see the chart below). In November 2013, Putin's approval index touched 24 points again after recovering slightly from the beginning of the year.

During most of 2013, aside from preparing for the Sochi Winter Olympics, Putin spent time corralling Yanukovych not to sign the EU association agreement and instead join the rapidly forming Customs Union. In the early fall of that year, Putin moved his "grey cardinal" Vladislav Surkov from a post in the presidential administration to an appointment as an official adviser over Ukraine. Surkov, well known as a master of orchestrating politics and propaganda in the Kremlin's favor, was designated to devise a scheme for Ukraine.

In late 2013 and early 2014, after Surkov was appointed, Yanukovych was deposed and fled to Russia, Crimea was annexed, and Donbas was in flames following the appearance of pro-Kremlin militants of north Russian descent.

Following the political unraveling that occurred in Ukraine, Levada registered Putin's approval index up to an all-time high in summer 2014 through January 2015 at above 70 points (see the Chart 5 and Chart 6 on p.7). Two waves of sanctions by the West, countersanctions by the Kremlin, and a raging anti-Western propaganda campaign all helped sustain Putin's high approval rating.

The Russian economy suffered a severe economic adjustment over 2014 as the price of Brent crude oil dropped 53% from US$108 to near US$50, causing a 53% decline in the ruble's FX rate to the US dollar. Inflation rose from 6.1% YoY to 15.0% YoY from January 2014 to January 2015. FX reserves declined 26% from US$506bn to US$376bn.

What is less widely known is that the Russian economic adjustment through FX devaluation has been massive (far more than initially thought) if measured by real trade-weighted terms (see the Chart 22 on p.26). The ruble indeed is in tatters, undervalued by 60%, which is a short-lived occurrence and will be quickly eliminated by inflation. Inflation in Russia is just heading up and the ruble should narrow its undervaluation to around 30-40%. Still, with such a currency misalignment, inflation is inevitable, but we project it to be about 20% in mid-2015, a massive increase versus a year ago.

[5] This is mid of the fair-value range of 38 and 52, which is derived from FX misalignment by CPI- and PPI-based real trade-weighted indices for Russia ruble.

This projection still implies that authorities are enacting nationwide administrative measures to convince private businesses (large and small) to not increase prices. There is anecdotal evidence[6] of a Russian cafeteria that, likely being pressured by local authorities from increasing prices, puts an additional item on a client's receipt, which is called “a ruble devaluation” and amounts to 10% of the total bill. In our view, as private businesses in Russia are unable to pass costs on to consumers, they will be forced to cut back in other areas like labor, which will strain the labor market further. Hence, the inflation problem will be compounded by an unemployment problem.

The above-mentioned economic deteriorations are captured by Levada’s opinion polls in its two indices of social mood and consumer mood (Chart 23 on p.28). These two indices, in our view, capture more information about the respondent and how he or she thinks as the poll consists of several questions on politics, the economy, expectations of the economy, and personal fortunes. These are more complex than the binary index of the Putin approval index, where “approve” and “disapprove” are the key answers. Between 2000 and 2008 there was a strong, positive correlation between the Putin index and the social mood index. In 2008, the positive correlation broke down as the social mood dropped in late 2008 while the Putin approval decreased much less dramatically. The correlation recovered and stood high for a while and then broke down again and turned negative for several months between December 2011 and March 2012 when Putin’s approval index was declining while the social mood was more or less stable. In early 2014, the correlation was strong and positive after the annexation of Crimea, but later in the year this correlation was breaking down as Putin’s approval index remained high while the social and consumer indices declined quite sizably. This correlation ratio is running toward zero now and even could stay negative for some time.

The general macroeconomic story in Russia over the next 2-3 years means that the social and consumer indices are expected to slide during 2015 because of a 5% YoY economic contraction, i.e. a recession, and the same trend is very much likely in 2016. Sustaining Putin’s approval index is a big issue now, despite a year-long anti-Western state propaganda campaign, and this task will require creativity and fine-tuning.

At this point, we return to the recent second Minsk summit. Prior to the meeting, the Kremlin knew that the Russian economy is in a deepening recession this year and possibly next year as well. The Kremlin's land grabbing and fighting with the West and NATO have been popular domestically. However, the threat of military supplies to Ukraine and of more sanctions should Russia refuse to adhere to a ceasefire and reduce aggression caused the Kremlin accept the agreement.

Although it is retreating from the outright escalation of aggression seen over the past two months, the Kremlin in the latest agreement managed to prevent the Ukrainian army from regaining control of the border until the end of 2015. This enables the Kremlin to sustain its proxies in the parts of Donbas occupied by separatists. As the media thrill of an armed conquest of Donbas will not captivate Russian TV viewers after the ceasefire and military withdrawal, Russia’s domestic economic problems will not wane. Because of this, we suspect that the Kremlin could engineer another escalation to rejuvenate Russian popular support and divert attention from the severe economic problems. Hence, the risk of reneging on the latest peace agreement remains a possibility.

[6] https://twitter.com/golub/status/559300696160628736

Politics

In our view, the domestic political area is likely to be quiet, putting a damper on the normal internal squabbling in the name of unity. While the parliamentary majority is unlikely to fall apart, incumbent politicians are more likely to unite in the face of the Kremlin's military aggression.

Domestic political consolidation as certainty

In our base case scenario, domestic politicians should consolidate in the face of Kremlin-inspired military aggression and the ongoing war with pro-Kremlin militants and the Russian army in the Donbas region. This development has an 80% probability despite the fractures between the key political groups that form the parliamentary majority.

In the worst case scenario, with a 5% probability, the current political incumbents will step down because of a popular revolt against austerity measures and fatigue from the Donbas war, to be replaced by a Kremlin-friendly government. In contrary to that scenario, our best case scenario, with a 15% probability, envisages a government re-shuffle that produces a more decisive action on the economic reforms agenda in the country.

Why local politics provoke violent geopolitics

The Kremlin realises that annexing Crimea reduces its ability to influence Ukrainian politics through the democratic election process as Crimean voters tend to vote largely in favour of the party that aired most prominently on the top Russian TV channels. The same is true in the regard to the Donbas area now under occupation.

Our analysis based on the bulk data of voters' activity during the recent parliamentary elections in comparison with parliamentary elections held in the fall of 2012 (see Table 3 and 4 on pp.16-17) yields the following suggestions.

First, despite the militarization shock from deaths among civilians and the military alongside the economic shock, voters changed little. Although 3.9m voters (excluding Crimean voters) fell from last year, 50%-plus of the registered voters still voted. An overwhelming share of those who dropped out was from the war-torn oblasts of Donetsk (1.5m) and Luhansk (0.9m). These oblasts saw their inhabitants leave the area for other parts of the country or abroad, including to Russia. The remaining were visible in the oblasts that have been free of war and had an historic sizable share of so-called Russia sympathisers. The decliners were in double digit area. These oblasts form the southeastern belt of Ukraine that the Kremlin claimed as a target for the new intervention. A rather expected outcome was in the two western oblasts of Chernivtsi and Zakarpattya (Transcarpathia) where a change between those who voted in 2014 versus 2012 was respectively negative and amounted to 19.0% and 13.4%.

Second, even if one suggests that all decliners (3.9m voters who did not vote in the 2014 elections) were to support the Kremlin's side, they would still fall short of winning the pro-Maidan vote (see 4 on p. 17 for details).

Hence, summing up the two factors mentioned above, for the Kremlin to inflate the number of voters that would support its position within Ukraine at net elections, potentially more domestic voters should be dissatisfied with current incumbent politicians of Ukraine. As a result, the current strategy by the Kremlin of a gradual draining of resources through military and economic destabilisation is likely to stay in place.

Table 3. The Ukraine voters between 2012 and 2014 during parliamentary elections

	Registered voters			Voters who took part in the elections			The 2014 shock on voters willingness to vote		
Country's regions	2012	2014	Change (%)	2012	2014	Change (%)	Number of voters who did not vote	Status of voters shift	Share of those who did not vote to registered voters (%)
Crimea	1,522,278	…		752,896	…			Annexed	
Vinnytsya	1,286,904	1,276,297	-0.8	809,394	741,379	-8.4	-68,015	Negative	5.3
Volyn	776,485	776,453	0.0	510,469	503,594	-1.3	-6,875	Negative	0.9
Dnipropetrovsk	2,671,117	2,632,656	-1.4	1,414,986	1,260,141	-10.9	-154,845	Negative	5.9
Donetsk	3,339,046	1,382,205	-58.6	1,991,386	447,932	-77.5	-1,543,454	Negative	111.7
Zhytomyr	1,006,520	994,619	-1.2	597,120	563,712	-5.6	-33,408	Negative	3.4
Zakarpattya	953,658	953,675	0.0	492,203	426,128	-13.4	-66,075	Negative	6.9
Zaporizhya	1,452,265	1,433,780	-1.3	812,850	676,693	-16.8	-136,157	Negative	9.5
Ivano-Frankisvk	1,072,658	1,065,899	-0.6	663,638	679,338	2.4	15,700	Positive	
Kyiv oblast	1,448,511	1,459,840	0.8	897,849	835,738	-6.9	-62,111	Negative	4.3
Kirovohrad	781,848	771,378	-1.3	424,222	414,429	-2.3	-9,793	Negative	1.3
Luhansk	1,799,335	457,007	-74.6	1,037,842	150,249	-85.5	-887,593	Negative	194.2
Lviv	1,970,677	1,959,474	-0.6	1,322,733	1,371,768	3.7	49,035	Positive	
Mykolayiv	922,687	913,763	-1.0	481,576	391,237	-18.8	-90,339	Negative	9.9
Odesa	1,810,880	1,788,341	-1.2	898,966	706,912	-21.4	-192,054	Negative	10.7
Poltava	1,192,234	1,180,786	-1.0	690,299	643,921	-6.7	-46,378	Negative	3.9
Rivne	864,813	864,440	0.0	534,745	515,163	-3.7	-19,582	Negative	2.3
Sumy	932,242	914,948	-1.9	537,772	500,018	-7.0	-37,754	Negative	4.1
Ternopil	854,103	841,484	-1.5	570,455	574,584	0.7	4,129	Positive	
Kharkiv	2,170,309	2,147,400	-1.1	1,152,050	973,208	-15.5	-178,842	Negative	8.3
Kherson	857,853	854,123	-0.4	436,699	353,316	-19.1	-83,383	Negative	9.8
Khmelnytsky	1,050,186	1,039,963	-1.0	654,686	626,255	-4.3	-28,431	Negative	2.7
Cherkasy	1,038,862	1,024,573	-1.4	638,535	574,335	-10.1	-64,200	Negative	6.3
Chernivtsi	699,843	697,798	-0.3	417,529	338,404	-19.0	-79,125	Negative	11.3
Chernihiv	879,265	861,237	-2.1	537,209	490,528	-8.7	-46,681	Negative	5.4
City of Kyiv	2,142,457	2,156,285	0.6	1,330,852	1,204,561	-9.5	-126,291	Negative	5.9
City of Sevastopol	303,093	…		150,511	…			Annexed	
Total	**35,800,129**	**30,448,424**	**-14.9**	**20,759,472**	**15,963,543**	**-31.8**	**-3,892,522**		
Voters activity* (% of registered voters)				**57.99**	**52.43**				

Notes: … annexed territories; * share of voters that took part in the elections to the number of registered voters.

Sources: Central Elections Committee of Ukraine (http://www.cvk.gov.ua/), ICU.

Table 4. Breakdown of the 2014 parliamentary elections by parties and blocs

Party / Bloc	Actual results: Share of votes (%)	Actual results: Number of votes	ICU judgment of affiliation: Pro-Maidan votes	ICU judgment of affiliation: Pro-Kremlin votes	ICU judgment of affiliation: Other
Peoples Front (led by Arseniy Yatsenyuk)	22.1	3,488,114	Y		
Petro Poroshenko Bloc	21.8	3,437,521	Y		
Self Assistance	11.0	1,729,271	Y		
Opposition Bloc (ex Party of Regions)	9.4	1,486,203		Y	
Radical Party	7.4	1,173,131	Y		
Batkivshchyna (led by Yulia Tymoshenko)	5.7	894,837	Y		
Svoboda	4.7	742,022	Y		
Communist Party	3.9	611,923		Y	
Strong Ukraine (led by Serhiy Tigipko)	3.1	491,471		Y	
Civil Position	3.1	489,523	Y		
Zastup	2.7	418,301	Y		
Right Sector	1.8	284,943	Y		
Women Solidarity	0.7	105,094		Y	
5.10 Party	0.4	67,124	Y		
Other parties	2.2	334,323			
Total votes	**100.0**	**15,753,801**	**12,724,787**	**2,694,691**	**334,323**
Share (% of total)			**80.8**	**17.1**	**2.1**
What if those pro-Kremlin votes increase by number of those who protested 2014 elections				3,892,522[1]	
Total votes		19,646,323	12,724,787	6,587,213[2]	334,323
Share (% of total)			**64.8**	**33.5**	**1.7**

Notes: [1] number of assumed protest voters that 100% equals to the number of voters who did not take part in the 2014 parliamentary elections (this is a severe assumption indeed), see Table 3, p.16; [2] total of pro-Kremlin votes and the assumed number of protest voters.

Sources: Central Elections Committee of Ukraine (http://www.cvk.gov.ua/), ICU.

Global economy

In the global economy, in our view, there are three areas of concern. First, the US dollar's rally, after its record eight consecutive month rise from July 2014 through February 2015, should resume later this year in the summer when the US Fed starts to raise its key policy rate. In our view, the US dollar is stabilising now along with commodity prices. Second, the Russian economic recession since early 2012 should continue through 2015-16. This has a negative impact on neighbouring countries that trade routinely with Russia. Third, as China's industrial sector continues to stagnate, authorities may allow the Chinese currency to weaken further, bolstering the US dollar even more later this year.

Complicated deflationary environment and a strengthening US dollar

The recent past

Over the past year, the global economy experienced three key factors that would produce a lasting legacy for the current year and next few years as well:

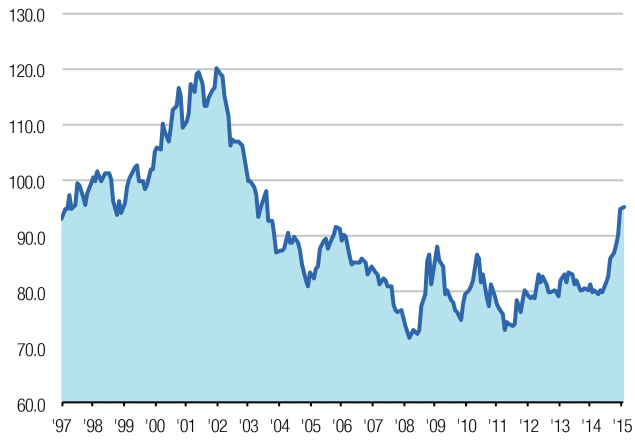
First, the long-anticipated rise of the US dollar began last year in July. It lasted eight consecutive months through February 2015, the lengthiest streak of appreciation of the US dollar in trade-weighted terms over the past 20 years. The dollar is now more dear than it was over the prior two peaks which happened in the wake of the Lehman crisis of late 2008 and of the Eurozone debt crisis in 2010. However, the dollar index, now at 95 points, is still below the peak of 120 points last seen in January 2002 in the wake of the 9/11 terrorist attack in the US. See Chart 9 and Chart 10 below.

Second, the US dollar's appreciation has caused a massive decline in commodity prices, namely in crude oil. Indeed, we attribute commodity price declines to the anticipated tightening by the US Fed. Other factors are secondary, in our view.

Third, China's economy is decelerating and its industrial sector has been stagnating over the last 2.5 years now, as proven by the deflation of its producer price index. This effectively has been restraining commodity prices as well.

Chart 9. Monthly history of the US dollar index (DXY)

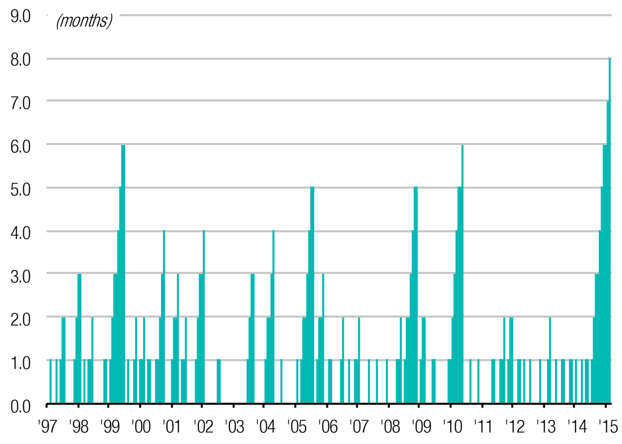
Monthly average values, history from January 1997 through February 2015



Source: Bloomberg, ICU.

Chart 10. Number of consecutive months of US dollar index appreciation (months)

History from January 1997 through February 2015



Source: Bloomberg, ICU.

The coming future

In our view, the beginning of 2015 symbolises quite a tricky juncture between a low-growth and disinflationary environment globally. In some parts of the global economy, outright deflation is occurring. The US economy has been standing out of the general pack in terms of its macroeconomic prospects during 2014 and early 2015.

A cascading wave of stimulating monetary policy in the major developed market economies - from the US (where monetary stimulation is being phased out) to Japan (since 2013) and to Eurozone (where a bold QE has just started) - has been creating spill-over effects on emerging market economies in one way or another. We discuss this tendency below.

Generally, we think that economic growth is likely to disappoint, i.e. actual growth rates will probably come in below expectations.

The Eurozone

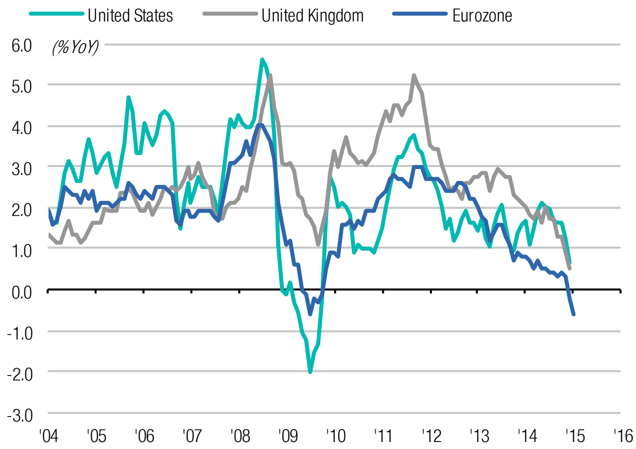
This is particularly true for the Eurozone, which, after a lengthy period of hesitation in the face of slow growth, accelerating disinflation (Chart 11), and the depressed economies of southern states, has just announced its own QE program of buying EUR60bn per month. With the euro now nearly 16% weaker than it was a half a year ago, this creates recessionary pressure on the economies that depend on trade with the Eurozone, where Russia and Turkey are prime examples worth mentioning in the regard to Ukraine's economic prospects.

These two emerging market economies share similar characteristics in terms of having the EU as a key trading partner and external debt being denominated predominantly in US dollars. The longer the Eurozone remains in a protracted trend of extremely low inflation (or deflation) and currency depreciation, the more it will disrupt the Russian and Turkish economies where inflation has been far bigger and the nominal devaluation of the domestic currencies could turn out to be inadequate.

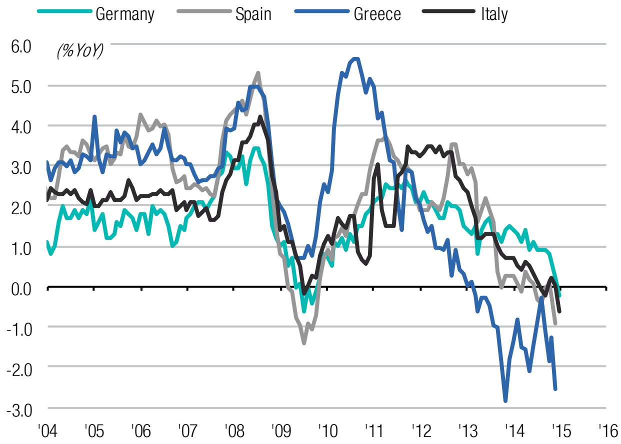
Thus, over the past several months through January 2015, Turkey has been eyeing a real appreciation of its currency because domestic inflation and the nominal strengthening of its domestic currency *vis-a-vis* the euro. Hence, Turkey has been adjusting to mirror the macroeconomic adjustment in the euro area. Russia's case is explained in more detail on p.22 in the section "Russian recessionary economy: An epicentre of negative spillovers".

Chart 11. Inflation in selected developed market economies (%YoY)

Monthly history from January 2004 through January 2015



Source: Bloomberg.



Source: Bloomberg.

US

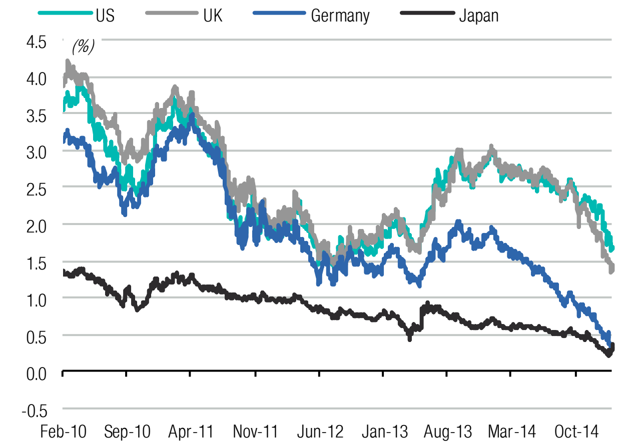
The US economy is being considered the only engine of vibrant growth among the developed market economies. Indeed, the quarterly real GDP growth rates in 2Q and 3Q of 2015 were quite impressive at +4.6% and +5.0%[7], respectively, while 4Q was at +2.6%, a lower-than-expected level. Headline numbers on the labor market have also been encouraging over the past half year, allowing for lower unemployment (5.6% in December 2015 versus 6.7% a year ago) and pushing the Fed to start increasing the key rate.

While full-year real growth of GDP in 2014 was 2.4%, a number of restraints are building up for further acceleration of growth in the US economy. These restrains include tighter monetary policy conditions due to expectations that the Fed's key policy rate will be raised this summer and because of the appreciated US dollar. Hence, a repeat of the 4-5% increase of quarterly GDP this year is beyond our expectations. Instead, we anticipate a growth rate of the trailing past few years' mean of 2.3%, below the expected 3% rate, but still a much healthier and steadier growth rate versus that of other developed major economies like the Eurozone and Japan where growth expectations currently remain slightly above 1%. This means that the divergence of growth between the US and other major developed nations is set to prevail despite the above-mentioned underperformance of actual economic activity. US sovereign debt currently yields more than its developed peers' debt (see Chart 12 below) and growth expectations for the rest of 2015 are likely to support the relative attractiveness of US assets going forward. This would provide grounds for another push to a US dollar rally in the summer this year lasting towards 2H. For the time being, it is likely that the seven-month-long US dollar rally that lasted through January is now fading away for a while, allowing for commodity prices to stabilize and even stage a mediocre recovery.

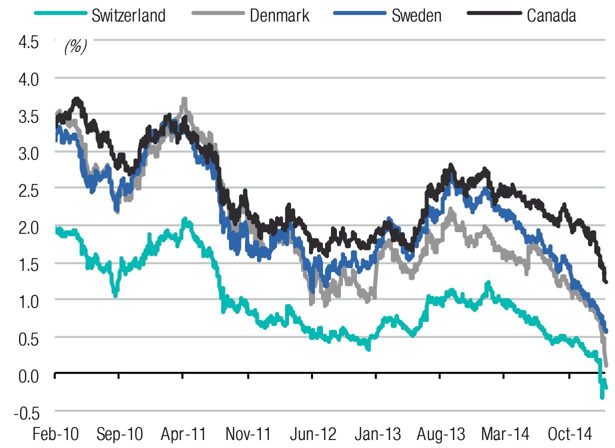
[7] In seasonally adjusted annual rate.

Chart 12. Yield on 10-year sovereign bonds of the developed market economies (%)

Daily history of last five years through 3 February 2015



Source: Bloomberg.



Source: Bloomberg.

China

China's economy is expected to maintain growth at an annual rate of about 7% in the coming few years, albeit at a decelerating rate. The current issue for the economy that had massive investments into infrastructure and real estate is the stagnation of its industrial sector, which is epitomized by a 30-month deflation in the producer price index. The deflation strengthened in the last months when it reached 3.3% in December 2014 from 1.4% a year before. Out of all the other major nations that are key global exporters—Germany, Japan and South Korea—deflation of producer prices is strikingly evident in South Korea, where it reached 2.1% last December.

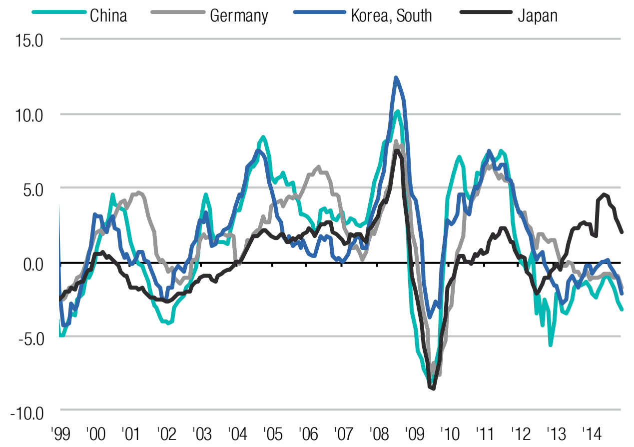
Germany's case as an economy that too has experienced an increased deflation (its PPI declined 1.8% from a year ago, or at the fastest pace since the 2008-09 economic crisis) appears less relevant because the ECB has started a QE that is effectively targeting an inflationary increase in the economy.

What makes China's economy stand out of this pack of peers as that it has the most expensive currency in terms of a real effective exchange rate (see Chart 14 below). South Korea also has a very similar issue. At a time when central banks of the Eurozone and Japan have been pushing their currencies lower, the Chinese and Korean exporters have been losing pressure. Hence, to sustain their domestic economies, China and Korea will likely tolerate weakness of their own currencies.

That is why a weaker Chinese currency is an integral part of our base-case scenario: it is likely to trend towards 6.3/USD over 2015 and early 2016. Although Chinese authorities could let the currency gradually decline towards 6.5/USD or even 6.8/USD, our worst-case scenario, as it would mean recessionary impulses and outright troubles could spread to the Eurozone and the rest of the BRIC countries. A much weaker Chinese currency (alongside the euro and Japanese yen as their central banks are poised to undertake expansionary monetary policies) would put upward pressure on the US dollar and downward pressure on commodities. This could result in even lower steel prices for Ukraine's steel-making sector.

Chart 13. China's PPI versus selected economies that have sizable export oriented industrial sector (% YoY)

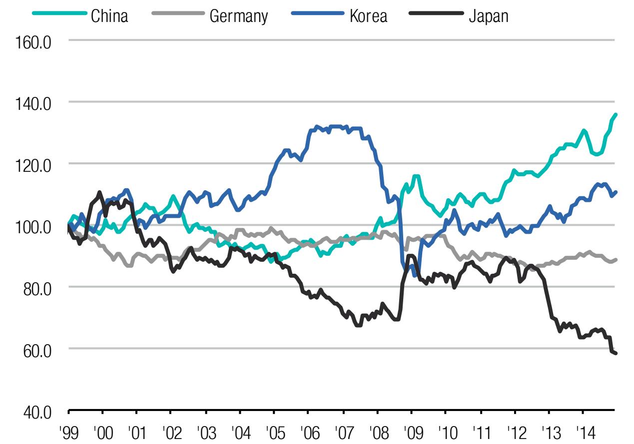
On-year perchance change.
History from January 2000 through December 2014



Source: Bloomberg, ICU.

Chart 14. China's real effective exchange rate versus selected economies that have sizable export oriented industrial sector

Rebased at 100 as of January 1999.
History from January 2000 through December 2014



Source: BIS, ICU.

Russian recessionary economy: An epicentre of negative spillovers

Geopolitical crisis as means to economic model change

In our view, Russian leadership is exploiting the geopolitical crisis with Ukraine and the democratic countries in general to shape a new economic model for itself. The old one, which was based on energy exports and steadily rising domestic incomes, proved to be not functional yet in 2012-13 when Putin returned to the presidency. We addressed the issue of the non-functional model of the Russian economy in our previous *Quarterly Reports*. Below, we highlight the key areas that shape the likely future for the Russian economy.

'The Dutch disease is over'

According to Russian Finance Minister Anton Siluanov, during 2014 the Russian economy suffered from the so-called “Dutch disease”. In his February 6 interview with Bloomberg (here[8]), he said 'the Dutch disease is over'. In our view, his statement reveals the genuine intentions of Russian policymakers back in 2013-14. While security people made a sideshow of the geopolitical crisis to divert attention, economic policymakers engineered an extremely swift elimination of that disease from the economy by quickly devaluing the domestic currency.

As Chart 15 shows, the Russian economy indeed suffered from an extraordinarily long period of high commodities prices, mainly for crude oil and natural gas, as inflation had been steadily eliminating the economy's external competitiveness. At the very beginning of 2014, authorities openly allowed the FX rate to weakening to34-35/USD. In our view, the arrival of so-called soft sanctions from the West as punishment for the Crimea annexation was a kind of boon for the Kremlin, weakening the ruble's exchange rate to 36/USD. Sanctions by the West effectively gave the Kremlin a viable excuse to blame over the Western nations for Russia’s inevitable economic pain. Later on, when the crude oil slump in 2H14 became a severe issue for Russia’s state budget, the ruble’s devaluation was not

[8] http://www.bloomberg.com/news/articles/2015-02-06/russia-s-siluanov-freed-by-ruble-collapse-to-slim-welfare-state

resisted that much. Instead, a move towards a 'floating regime' was declared and the currency dropped massively in nominal as well as in real terms (Chart 16). In practice, the Kremlin introduced implicit capital controls, forcing corporations to sell FX into the market, and leaving its government no alternative but to implement an emergency crisis-management plan (now pending).

Chart 15. Russia's CPI-based real effective exchange rates*

Monthly history from January 1994 through December 2014

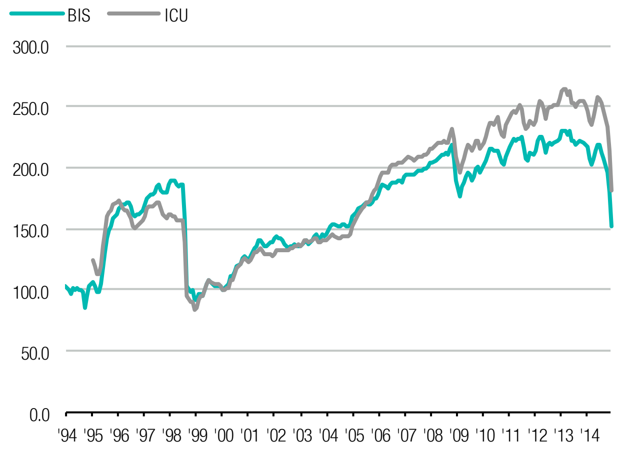
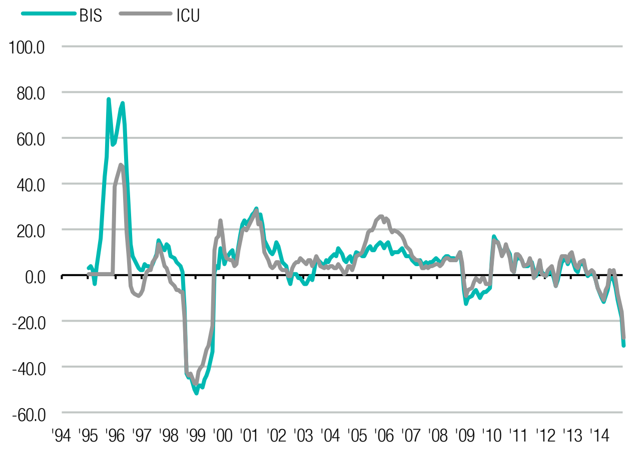


Chart 16. On-year growth rate of Russia's CPI-based real effective exchange rates*

Monthly history from January 1994 through December 2014



Note: Rates are as calculated sourced by BIS (http://www.bis.org/statistics/eer/index.htm) and ICU (http://www.icu.ua/en/research/currency-indices). Source: BIS, ICU.

Foreigners as useful targets for public anger

Over the course of 2014 and early 2015, Russian authorities managed rather quite well to maintain voter confidence in regard to the public's anger over the profound economic reversal. According to our best knowledge, only one official was removed from a prominent position, and that was Ksenia Yudaeva, the first deputy to the Russian central bank governor, with the prime responsibility of directing monetary policy. She was merely demoted to a less prominent role in the central bank, being replaced by an experienced ex-central banker. All other government officials retained their offices, despite the fact that the economy officially has been in a protracted multi-year slowdown. Unofficially, the economy experienced a short and shallow recession in 2Q of 2013; this year it is expected to decline by approximately 5% YoY.

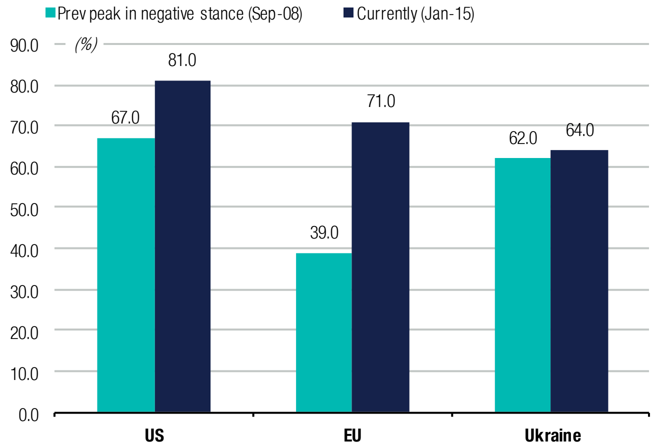
A key to the Kremlin's success in terms of managing public sentiment so far has been its masterful use of propaganda through state-controlled media which depicted Mother Russia as being under siege by the old enemies of the West. The narrative has been simple: Russia has suffered severely as a result of the economic problems coming from the unstable, rapacious foreign markets. Naturally, there is sick silence over the home grown origins of the economic problems in Russia. The Kremlin's propaganda machine exploits the traditional suspiciousness toward and feeling of betrayal by the West, the public's syndrome of Russia's lost greatness and its faded empire, and finally the centuries-long religious dogma over the standoff between Orthodox Christianity and the Roman Catholic Church.

The public, baffled by the current complications and what will become of the country, are easily swayed by the Kremlin's propaganda. The charts below depict the results of a recent public opinion poll in Russia that clearly suggests the public's immediate and subconscious reaction to the question of whom is to blame for the domestic economic troubles points directly to the West (US and EU) and Ukraine. Moreover, the Kremlin's propaganda successfully erased a meaningful difference between the EU and NATO, and they have become interchangeable entities. Hence, when the Kremlin says it objects to Ukraine's membership into NATO, it also clearly implies that this objection spreads to EU membership as well.

Under this premise, the Kremlin will exploit this Russian public feeling as long as it can tolerate its economic troubles which are likely to worsen as the current macroeconomic adjustment will be prolonged. Moreover, inflation and unemployment are also significant issues for the Russian economy in 2015-17.

Chart 17. Share of respondents who say they have 'negative' (or 'bad') stance to the US, EU and Ukraine (%)

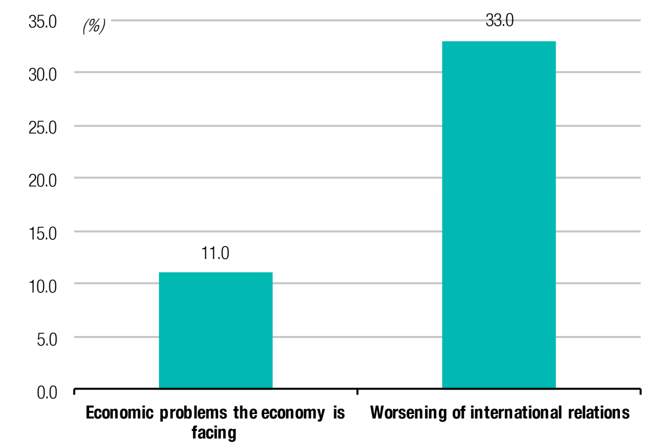
According to polls conducted by Moscow-based Levada Centre



Note: Previous peak in negative stance was under Bush presidency during the Russian war on Georgia. Source: Levada.ru, ICU.

Chart 18. Increase in share of respondents (percentage points), who has become more worried over an issue

According to polls conducted by Moscow-based Levada Centre



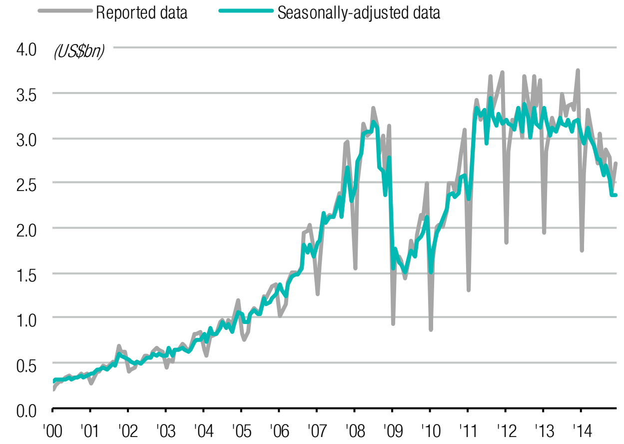
Source: Levada.ru, ICU.

A recessionary Russia pulls down neighboring economies

As we noted above, the macroeconomic adjustment of the Russian economy could be a multi-year dilemma after at least two years of outright stagnation. The two charts below prove that Russian domestic demand (for a variety of reasons) has been stagnating since early 2012 when the monthly volume of Russian imports from Germany, which serves as a bellwether to domestic demand conditions as the wealthy and middle class buy German cars and businesses buy German-made capital goods, stopped growing in early 2012 and were propped up until an outright contraction occurred in early 2014.

Chart 19. Monthly volume of Russian imports from Germany: reported and seasonally adjusted data (US$bn)

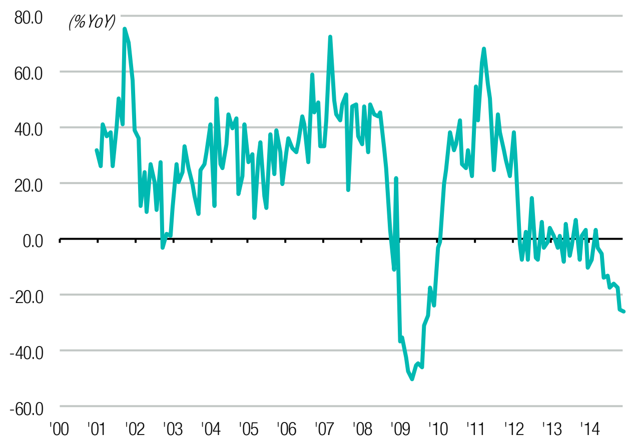
Monthly history from January 2000 through December 2014



Source: State Customs Service of Russia, ICU.

Chart 20. On-year change in the seasonally adjusted monthly volumes of Russian imports from Germany (%YoY)

Monthly history from January 2000 through December 2014



Source: State Customs Service of Russia, ICU.

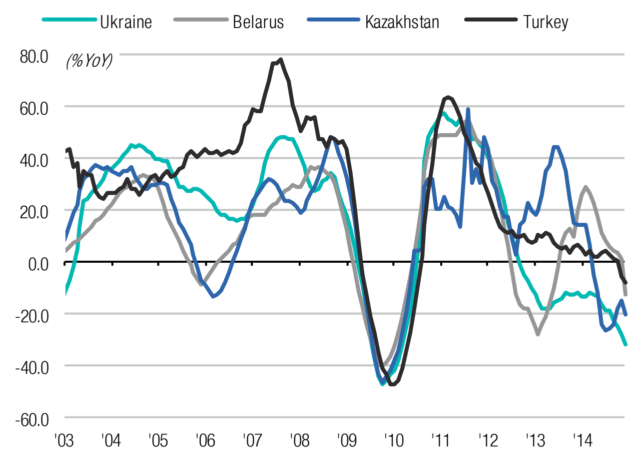
Recessionary tendencies stemming from the Russian economy have been visible from 2013. For instance, the Kremlin's talk on the creation of an economic union with neighboring countries like Belarus, Ukraine and Kazakhstan bolstered Putin's approval ratings (the restoration of economic and political control over ex-members of the lost empire is highly popular in Russia). On the other hand, this talk has nothing to do with concerted efforts to avert slowing demand from Russia for goods produced in trading partner countries. As shown in Chart 21 below, Russia's key trading partners that largely depend on exporting to Russia have seen a decline in demand; hence, Russian imports were slowing down. In Russia, Belarus and Kazakhstan, the fortunes in trading with Russia were quite shaky.

Thus, Ukraine suffered an outright contraction in exports as the Kremlin closed the Russian market to Ukrainian exports citing they did not meet Russian standards. This action was a sideshow, in our view, and the real objective was to divert orders to domestic producers to sustain operations because the economic troubles have been piling up for the Kremlin.

Interestingly, as Ukrainian exports to Russia declined since mid-2012, exports from Belarus and Kazakhstan, although quite volatile, still held up in 2H of 2013. While one might suspect that the Russian economy could not ban all Ukrainian products (namely, food), it was forced to import products from Belarus and Kazakhstan because they joined the Customs Union (later renamed into Eurasia Union).

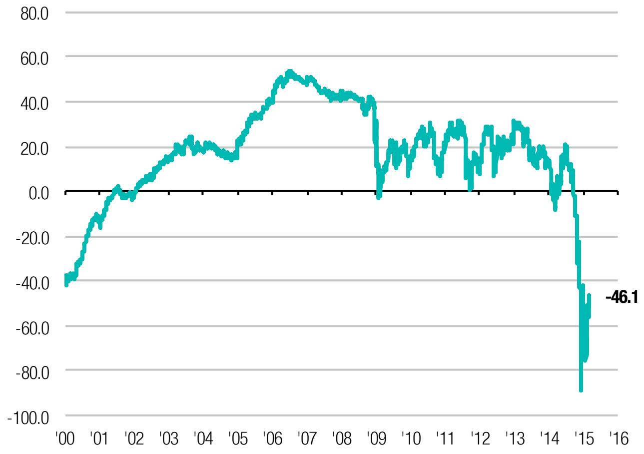
Nevertheless, in 2014 both Belarus and Kazakhstan were forced to rethink their economic relations as the Russian economy plunged into recession.

Chart 21. On-year growth of Russian imports from selected economies (%YoY, annualised data)



Source: State Customs Service of Russia, ICU.

Chart 22. Ruble's misalignment in real trade-weighted terms
Daily history from 1 January 2000 through 3 March 2015



Source: ICU.

In early February 2014, Kazakhstan devalued its own currency in a surprise overnight move. At that time, that decision placed the Kazakh currency ahead of the Russian ruble in terms of external competitiveness by (as it was thought then) a sizable margin. In our view, Kazakh authorities decided to make that unpopular move to prevent the ruble from becoming more competitive. After the ruble collapsed during 2H14, Kazakh authorities now face the very issue they were trying to avoid – the ruble's devaluation overshot theirs. The Kazakh currency is much less competitive than it was a year ago before its own devaluation. Kazakh authorities now see the domestic market flooded with Russian imports priced lower than their domestic products. As a result, the Kazakh economy will experience a GDP contraction and eventually will be forced to devalue its currency again later in 1H15.

In Belarus, authorities are having the same issue. Despite the fact that its currency was quite soft in 2013-14, following the Russian ruble's severe devaluation, Belarusian authorities were forced to use capital controls to cool down the first wave of panic buying of US dollars and ultimately had to devalue their own currency further in early 1Q15.

Ruble is in tatters now, a lengthy inflation pressure to follow

In our view, the Russian ruble underwent a massive devaluation both in nominal and in real trade-weighted terms. Thus, Chart 22 depicts the ruble's misalignment over nearly 15 years. It shows that while the ruble was positively misaligned (which means it was overvalued) throughout most of 2002 to 2H14, except during short-lived occasions, it turned to negative misalignment of sizable proportions[9]. That is why the ruble is, in our view, really in tatters and is cheap now.

However, with such a sizable negative misalignment, the natural outcome of this state of the economy should result in a massive adjustment of domestic prices. Indeed, monthly headline CPI statistics in Russia show that over the past three months inflation accelerated +1.3%, +2.6%, and +3.9% month-on-month increases, up three-fold from the normal

[9] Indeed, these proportions are too sizable, in our view. Moreover, they are pretty unrealistic and should be quickly eliminated by inflation, which gears up, so that over few month time that sizable negative misalignment of 70% fades away and it lowers towards more realistic one of 40% or less.

monthly increase in the price index in this comparable period. As a result, on-year inflation rose to 15.0% YoY[10] in January 2015 up from 6.1% YoY a year ago.

The Russian government acknowledges that inflation in 1H 2015 will be double digit but then should subside. In our view, this is a best-case scenario for the Russian economy because in reality authorities have been trying to dump inflation via administrative measures by talking directly to business owners (small and big ones) and advising them to avoid price increase. For example, there was media report[11] on the government efforts to prevent price increases by steel-makers. There are also anecdotic evidence of government efforts in taming down inflation – one of them was making rounds in social media recently[12]. It shows that provincial authorities in Russia were given orders from the government to prevent price increase so that consumers would not be hurt. Such a tactic, while being initially successful, most likely will backfire through other channels like businesses, being unable to pass increased costs to consumers, would be hit by lowered profitability or outright lack of profitability. Hence, their natural reaction would be to cut back on everything allowed by authorities. In our view, inflation would slowly unfold in Russia as quick price adjustments are being not allowed by authorities. Labor market would see more strains. This would mean also declining living standards. Hence, all of this would gradually fuel public discontent over the authorities.

How long a militarized and aggressive Russia is capable to last?

This is a tricky question to address in the face of Putin's high public ratings from various respected pollsters.

However, Russian public opinion can be evaluated with some insight. Using Levada (www.levada.ru), a Moscow-based pollster, as the primary source of data for our research, we reviewed three series of data - the Putin approval index (starting from 1999, the social mood index (starting from 1995), and the consumer mood index (starting from 2008).

The latter two indices capture a much wider picture of the public views of Russian well-being as they ask several questions. The social mood index has 12 questions on politics, the economy, personal well-being, and personal attitude toward political leaders. The consumer mood index has five questions that focus on a respondent's personal and family wellbeing, current economic conditions in general, prospects for the entire economy, and personal economic prospects.

Chart 23 below provides an historical perspective of these three indices. There is a remarkably strong positive correlation between Putin's approval index and the social mood index between 1999 and through most of 2008. In late 2008, the correlation diverged for a short period of time. Then, the social mood index (as well as the consumer mood index) declined quickly and it took few months in 2009 for Putin's approval index to decline as well and restore a positive correlation. 2010 appeared to be the longest period when the correlation was negative between the Putin and social mood indices, because Putin's approval was declining to lows. In 2014, there was a period earlier in the year when the social mood index and Putin's approval index both rose due to domestic euphoria over the annexation of Crimea. In the second half of 2014 to the present, the correlation collapsed, implying a divergence between Putin's high approval index and the declining social and

[10] As of 9 February 2015, headline CPI was at 15.6% YoY, implying further acceleration of inflation has been taking place.

[11] http://www.vedomosti.ru/politics/news/39215251/manturov-dal-metallurgam-dve-nedeli

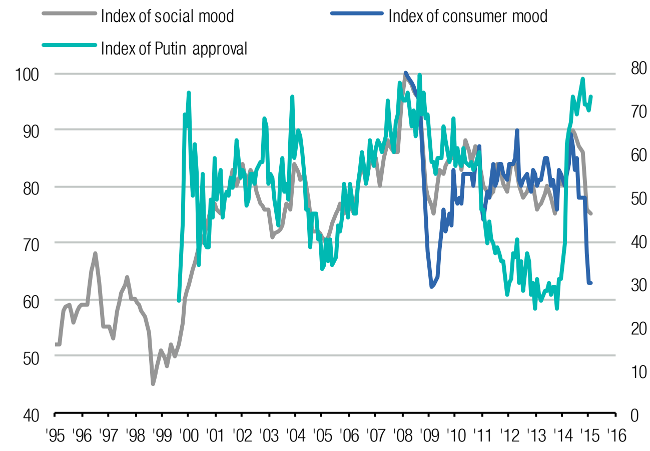
[12] https://twitter.com/golub/status/559300696160628736

consumer mood indices. As previous episodes of a very low or negative correlation between these two indices were quite short (when the correlation ratio in the negative territory lasted the longest for nine months in 2010), if history has any relevance in the future, then the current low and negative correlations could last about nine months. As the Russian economy is still going to be in recession over the course of this year and early next year, Putin's approval index could be heading down.

The Kremlin most likely realizes this and it could try to sustain its high approval rating by initiating a new wave of aggression in Ukraine or some other neighboring country which will find itself mired in this crisis.

Chart 23. History of social indicators in Russia: Indices of social mood and consumer mood versus Putin approval index

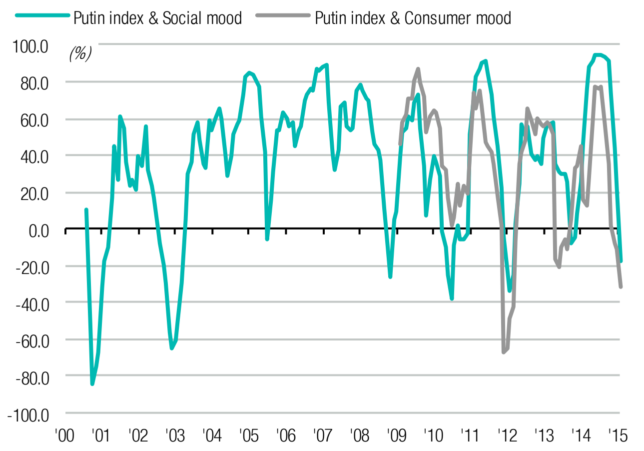
Monthly history from January 1995 through February 2015



Source: Levada.ru, ICU.

Chart 24. One-year correlation ratios between Putin approval index and indices of social and consumer moods (%)

Monthly history from January 2000 through February 2015



Source: ICU.

Commodities vital to Ukraine

Growth assumptions

Our base-case scenario for global economic growth is derived from the IMF's view as published in the updated World Economic Outlook in January 2015[13]. Global growth for 2015 is assumed at 3.5% YoY and 3.7% annually in 2016-17. The Russian economy is expected to contact 5% this year and 1% in 2016, with a recovery expected in 2017 (see Table 5, p.29)

Commodities' assumptions

In our previous *Quarterly Report*[14], our crude oil price projections proved to be wrong as we did not anticipate an outright decline of the WTI crude oil price to US$60. We now assume that the crude oil price will recover from the current level of US$51.21/bbl[15] to US$58 at the end of 2016 and to US$63 in 2017. In 2015, the crude oil price could dip again after the recent recovery as the US Fed starts raising its key policy rate this summer. This would cause the US dollar to rally against major global currencies, which would cause the crude oil price to decline. Our year-end projection for crude this year is US$50. On steel prices,

[13] http://www.imf.org/external/pubs/ft/weo/2015/update/01/

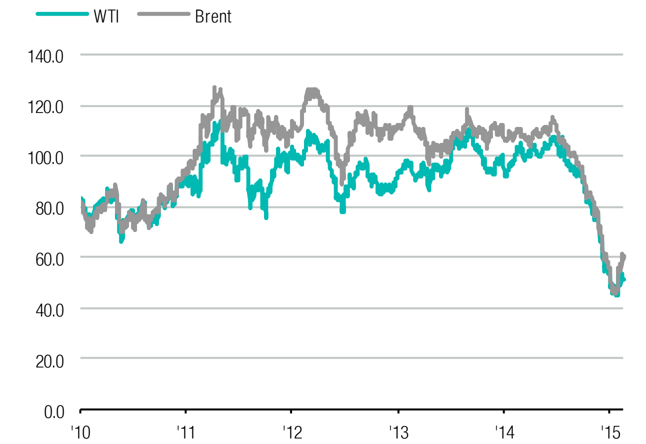
[14] http://www.icu.ua/download/1006/ICUQtlyReport-20141112.pdf

[15] as of 12 February 2015.

we assume stagnant global steel markets for the same reasons - a strong dollar and slowing Chinese economic growth where the industrial sector is set to decline relative to services as its economy rebalances from fixed investments to consumption.

Chart 25. Crude oil price (US$ per barrel)

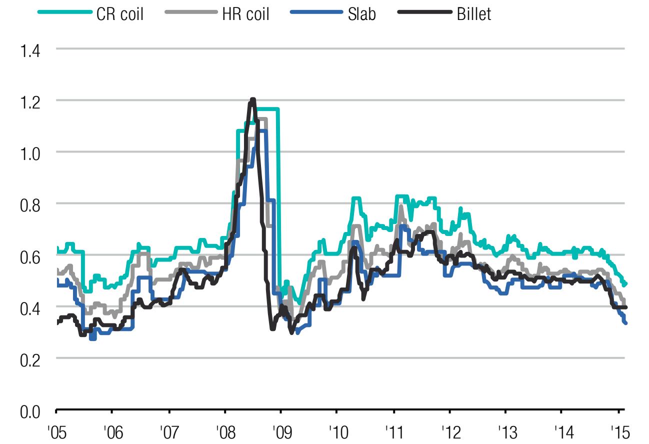
Spot and futures market daily quotations



Sources: Bloomberg, ICU.

Chart 26. CIS export steel prices (US$ 000s per tonne)

Quarterly averages



Sources: Bloomberg, ICU.

Table 5. ICU's 3-year quarterly and yearly forecast for the global economy's key indicators vital to Ukraine's economy, according to our base-case scenario

	Quarterly forecast												Annual forecas		
	1Q15F	2Q15F	3Q15F	4Q15F	1Q16F	2Q16F	3Q16F	4Q16F	1Q17F	2Q17F	3Q17F	4Q17F	2015F	2016F	2017F
World real GDP[1]	3.5	3.5	3.5	3.5	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.7	3.5	3.7	3.7
Russia real GDP[1]	-5.0	-5.0	-5.0	-5.0	-1.0	-1.0	-1.0	-1.0	2.0	2.0	2.0	2.0	-5.0	-1.0	2.0
Crude oil (US$[2])	48.6	48.0	49.0	55.0	56.0	57.0	58.0	60.0	61.0	62.0	63.0	65.0	50.2	57.8	62.8
Steel (US$[3])	426.0	408.0	421.0	434.0	447.0	473.0	473.0	473.0	473.0	473.0	473.0	473.0	422.3	466.5	473.0
EUR/USD (eop)	1.11	1.10	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.21	1.21	1.21	1.10	1.20	1.21
USD/RUB (eop)	63.00	65.00	68.00	70.00	70.00	70.00	70.00	70.00	70.00	70.00	70.00	70.00	70.00	70.00	70.00

Notes: [1] real GDP growth rate to previous year; [2] crude oil price is WTI crude and priced as per barrel; [3] steel price is HR coil price and priced as per tonne;
[4] crude oil and steel prices are the average for the period.

Source: ICU.

Ukraine's economy: Update

The emergency state of the economy should extend well into 2015 and very likely into 2017 when we see the only foreseeable growth comeback. While the external and fiscal position remains stretched, allowing for a projected 6% central government budget deficit and public debt exceeding 100% of GDP. The hryvnia is in serious distress after the recent selloff. Tighter capital controls should continue in 2015-16.

Economic activity: Recession lengthens, deepens

Given the most recent data from the state statistics office on key sectors of the Ukrainian economy (through January 2015), it is becoming evident that the economic contraction has deepened and any recovery will not occur until 2017 rather than 2016 (as previously thought).

Thus, such key economic sectors as industry, which saw industrial production declining by 10.7% YoY in 2015, is likely to experience contract an additional 8% YoY because of the occupation of the Donbas area by pro-Kremlin militants and their continued aggression. We do not foresee economic activity normalizing in the region that is the center of steel-making and coal-mining, which are significant contributors to Ukraine's economy. During 2016-17, our base-case scenario envisages stabilisation of the sector with flat growth followed by a 5% YoY recovery in 2017 (Chart 29, p.32).

Agriculture, which has become a real backbone of the economy over the past few years thanks to substantial increase in production and record high harvest in 2013-14, is projected to decline this year by 2% YoY because of the unsustainable volumes of production seen in the past two years. Another record-breaking harvest in 2015 is improbable. Moreover, the ongoing banking sector crisis and strained bank lending market are likely to leave agriculture firms underfinanced this spring during the sowing season. After this year’s decline in production, the sector is forecast to post growth at 5% each year in 2016-17 (Chart 27, p.32).

Retail trade, which recorded a 9.6% YoY decline in the past year, is forecast to recover gradually in 2016-17 by posting a price-adjusted increase of 5% and 8%, respectively, while a 5% contraction is envisaged in the current year (Chart 28, p.32).

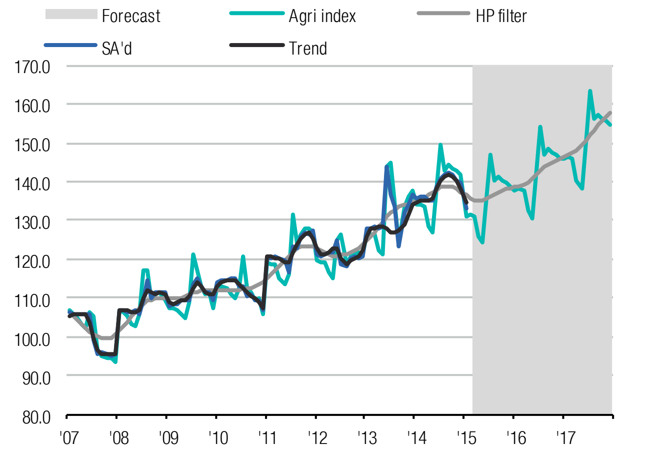
The construction sector is projected to suffer from the ongoing banking sector crisis. Other sources of lending are limited as well, including the bank credit market and wealthy and middle class individuals, negatively affected by the economy, who would otherwise invest in real estate. However, because of low base effect, slow growth does translate into a steady recovery of the sector from before 2014. For the current year, 3% real growth is forecast, and 5% annually in 2016-17 (Chart 30, p.32).

The transportation sector is set to recover after a war-driven deep contraction in 2H14 that could be the trough of the current year. We could experience a recovery in 2016-17 when cargo and passenger turnover is forecast to increase respectively by 8% and 10%, and 7% and 10%, each year. This year, transportation is still contracting as Kremlin military aggression does not allow the economy to normalize (Chart 31 and Chart 32, p.32)

Because the Minsk 2 ceasefire agreement appears to have failed (or was just tactical manoeuvring by both sides), we expect prolonged Kremlin aggression towards Ukraine in the economic, information and military spheres. Also, as the restructuring of Ukraine's economy by government authorities depends on these factors, we prudently expect the economic recession to lengthen and deepen. A standoff between Ukraine's army and pro-Kremlin militants is included in our base-case scenario. The recent disappointing statistical data on key sector economic growth in January 2015 reinforces our pessimism. As industrial production and cargo transportation have hit historical lows, resulting in a 6.7% contraction in real GDP in 2014, we project more a severe decrease of 7.6% in 2015, then flat growth in 2016. Only in 2017 do we expect a recovery of near 3% YoY.

Chart 27. Agriculture production index

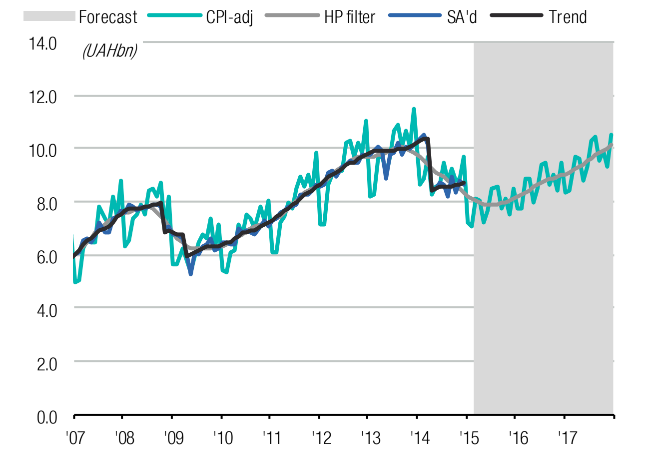
History (from January 2002 through January 2015) and forecast for 2015-17



Source: State Statistics Office of Ukraine, ICU.

Chart 28. Retail trade (UAHbn, at constant prices of Dec-1999)

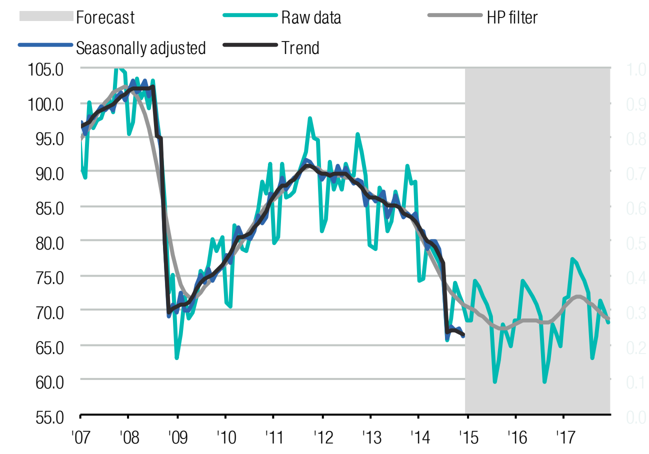
History (from January 2002 through January 2015) and forecast for 2015-17



Source: State Statistics Office of Ukraine, ICU.

Chart 29. Industrial production index

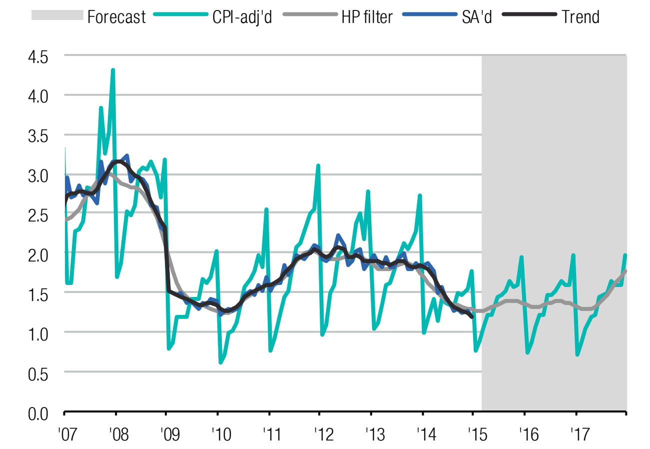
History (from January 2002 through December 2014) and forecast for 2015-17



Source: State Statistics Office of Ukraine, ICU.

Chart 30. Construction (UAHbn, at constant prices of Dec-2001)

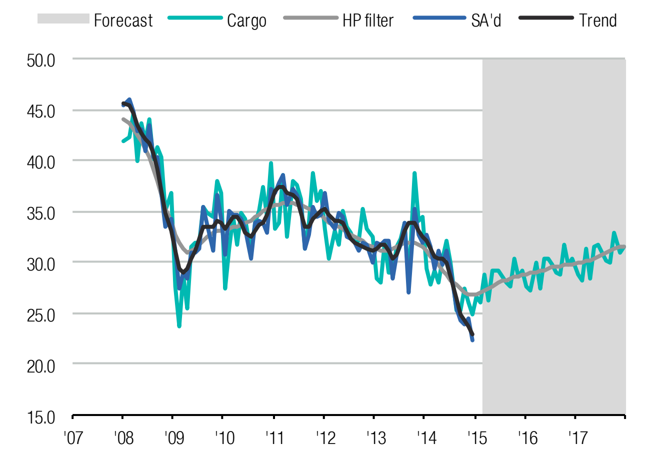
History (from January 2002 through December 2014) and forecast for 2015-17



Source: State Statistics Office of Ukraine, ICU.

Chart 31. Cargo transportation turnover (m tonne * km)

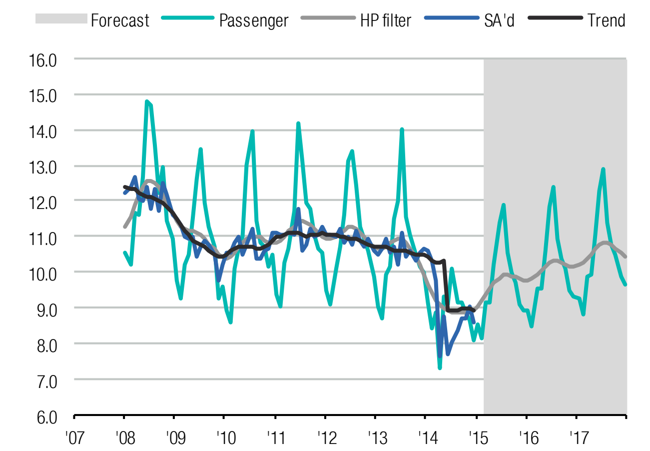
History (from January 2002 through December 2014) and forecast for 2015-17



Source: State Statistics Office of Ukraine, ICU.

Chart 32. Passenger transportation turnover (m * km)

History (from January 2002 through December 2014) and forecast for 2015-17



Source: State Statistics Office of Ukraine, ICU.

Adjustment takes its toll on domestic demand

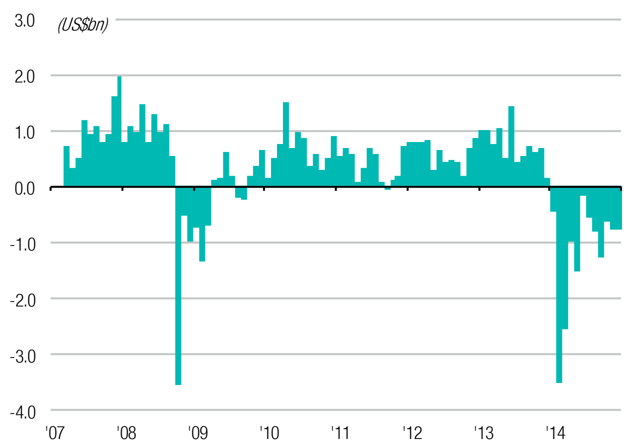
The macroeconomic adjustment that began in early 2014 (and continues this year) took its toll on the domestic economy through various channels. The effective macroeconomic jolt to the economy is much more profound this time than it was during the previous 2008-09 crisis.

Credibility and faith in the banking sector has been destroyed. Depositors no longer trust banks and banks no longer trust one another.

Depositors have been withdrawing funds since January 2014 and total household deposits have declined by UAH158.2bn (US$14bn). In comparison, US$7.8bn was withdrawn from banks in the 2008 crisis (Chart 33). That depositors have withdrawn FX deposits more rapaciously than they did in the 2008-09 crisis suggests that the private sector fears that the government will impose strict capital controls to maintain its key functions like paying for critical imports and redeeming FX debt to external creditors (see Chart 36). The interbank money market has been also functioning with a sizable decline of credit between banks.

Chart 33. US dollar equivalent of monthly flows on household deposits in the commercial banks (US$bn)

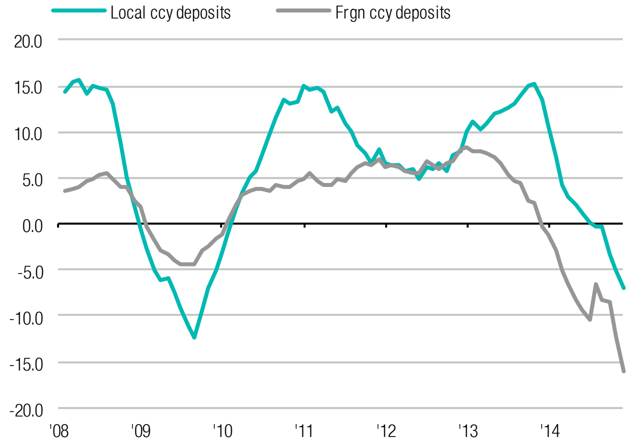
Monthly history from January 2007 through December 2014



Source: National Bank of Ukraine, Investment Capital Ukraine LLC.

Chart 34. US dollar equivalent of monthly flows on commercial banks' all deposits* (US$bn)

12-month rolling data

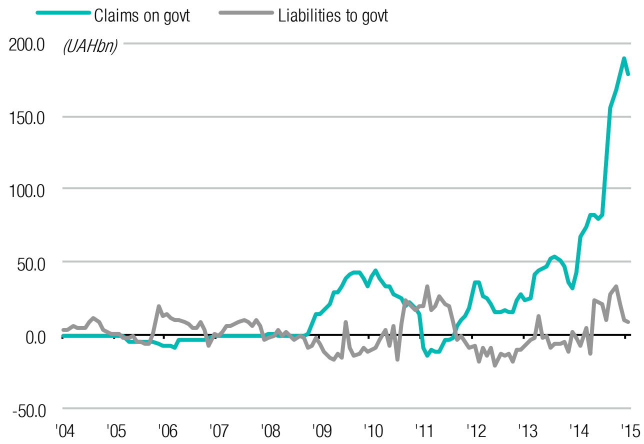


Note: * all deposits, including household deposits and other clients' deposits.
Source: National Bank of Ukraine, Investment Capital Ukraine LLC.

The banking sector in the current crisis has been plagued by serial devaluations and an inflationary spike. Moreover, in the 2008-09 crisis, the NBU and commercial banks purchased nearly equal volumes of debt securities' from the domestic market; in the current crisis, the NBU purchased UAH189bn versus UAH9bn for the commercial banks. See Chart 33 and Chart 34 on p.33.

Chart 35. Monthly history of flows of the central bank's clams and liabilities on the government (UAHbn)

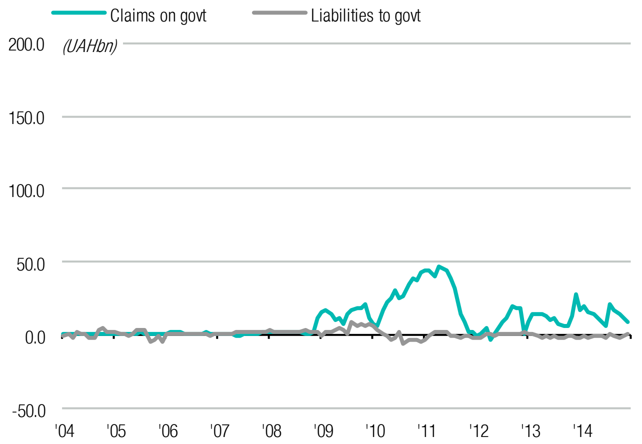
12 month rolling volumes. History from January 2004 through January 2015



Source: National Bank of Ukraine, ICU.

Chart 36. Monthly history of flows of the commercial banks' clams and liabilities on the government (UAHbn)

12 month rolling volumes. History from January 2004 through December 2014



Source: National Bank of Ukraine, ICU.

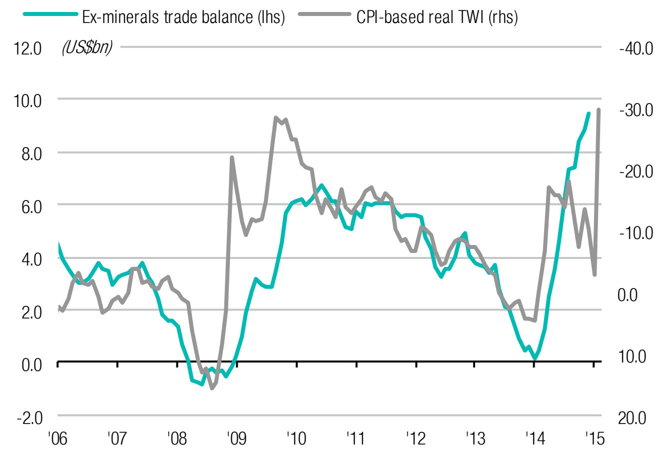
Overall, domestic demand has declined severely since 2014 due to the serial devaluation of the hryvnia from 8/USD in 1Q14 to 28/USD in mid-1Q15. This in itself has been a product of the above-mentioned retrenchment of the private sector of the economy to the domestic risk (local currency assets like cash currency and deposits in the banks). In effect, merchandise imports have been declining since April 2013 and plummeted in 2014.

One of our preferred gauges of domestic demand conditions is the ex-minerals trade balance, which eliminates energy-related trade from total trade as energy subsidies distort the elasticity of energy consumption in relation to the price of energy. As of the end of 2014, the last 12-month volume of the ex-minerals trade balance was in a surplus and it increased to US$9.5bn, or 7.3% of GDP, from US$0.7bn, or 0.3% of GDP, a year ago (Chart 38). In the wake of the 2008-09 economic crisis, the ex-minerals trade surplus increased from a small deficit to US$6.0bn and stopped growing at that time as the economy stabilized. This year, the ex-minerals trade surplus is most likely to surpass the 2004 peak of US$10.4bn as the UAH devaluation that occurred in January-February will depress domestic demand even further.

Our base-case scenario envisages a reduction of the merchandise trade deficit from US$5.4bn in 2014 towards US$1.6bn. However, due to the sizable economic contraction in 2014-15, the trade deficit as a share of GDP is forecast for a small contraction from 4.2% to 2.7%. The current account deficit is set to decline from 3.8% of GDP as of end -014 to 3.4% as of end -2015.

Chart 37. Correlation between ex-mineral trade balance and UAH's misalignment by CPI-based real trade-weighted index

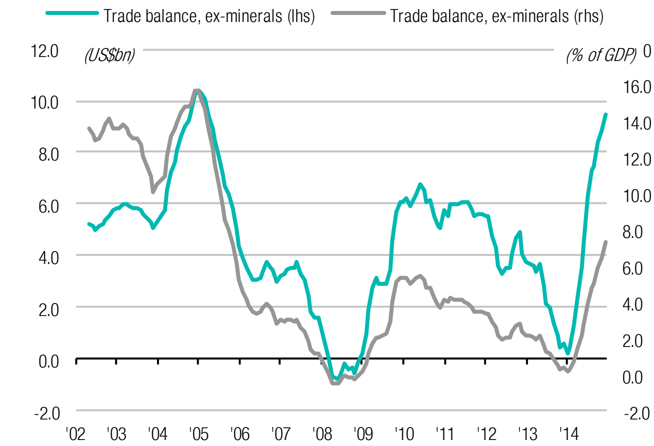
*Monthly 12-month rolling volumes. History from January 2006 through February 2015**



Note: data on ex-minerals trade balance is available through December 2014.
Source: State Statistics Committee of Ukraine, ICU.

Chart 38. Ex-minerals trade balance as an indication of domestic demand conditions (progressing towards zero = demand expansion; progressing away from zero = demand contraction)

Monthly 12-month rolling volumes. History from January 2002 through December 2014



Source: State Statistics Committee of Ukraine, ICU.

Public finances: Timid fiscal consolidation

In our view, the 2015 state budget law that envisages UAH563.2bn of central government expenditures and UAH498.2bn in revenues reflects quite an ambitious government, which aims to increase the level of central government expenditures by 3.5ppt from *de-facto* 27.7% in 2014 to 31.2% in 2015, according to our GDP projections. It targets revenues to increase 4.6ppt from an actual 23.0% in 2014 to a forecast 27.6% in 2015. This is by far too ambitious; most likely, it assumes that the Minsk ceasefire holds, which is already wrong.

Our base-case scenario foresees the central government budget deficit to nearly double, per the government's 2015 state budget law, to UAH141bn versus UAH76bn.

Moreover, our analysis of the banking sector (a quarterly report on the commercial banks *Banking Sector Insight* is forthcoming) yields that the total recapitalization needs of commercial banks under the current FX rate is about UAH200bn, up from the UAH170bn quantified in ICU's *Banking Sector Insight* dated 8 December 2014[16]. The government is planning to spend at least UAH56bn on bank recapitalizations, which appears to be insufficient. The Naftogaz deficit and higher natural gas tariffs on households is being undercut by FX devaluations[17]. The public sector deficit with Naftogaz included again risks hovering near 10%.

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[16] http://www.icu.ua/download/1037/ICUDebtInsight-20141208-print.pdf

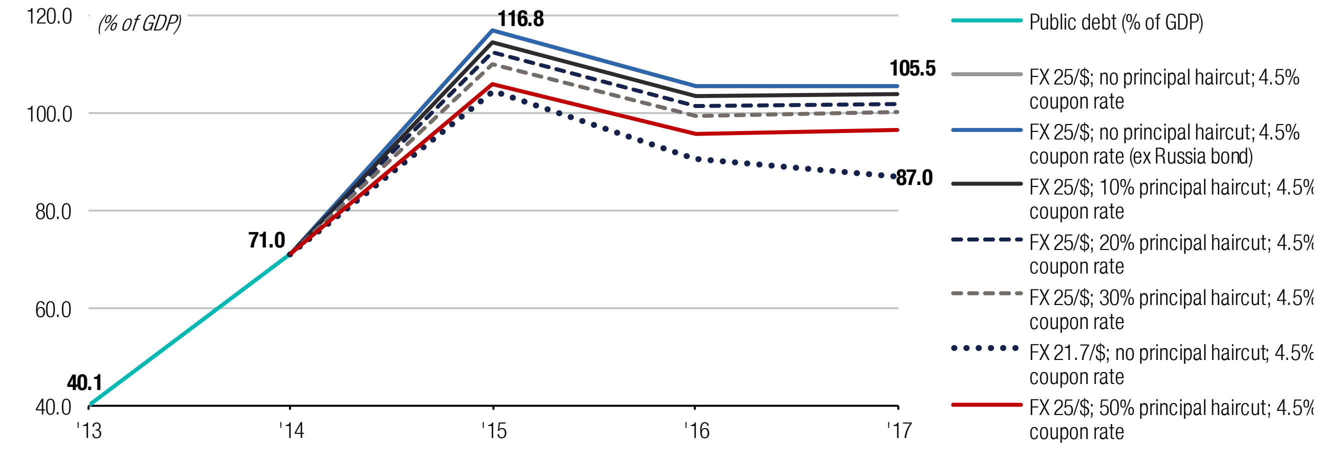
[17] Authorities still cannot decide how quickly act on eliminating the Naftogaz deficit. Thus, on 18 February 2015 NBU governor Ms Gontareva said that natural gas tariffs would be increased by 280% and for heating utilities by 66% (source: http://interfax.com.ua/news/economic/251277.htm in Russian). Whereas, on 19 February 2015 Minister of Finance Ms Yaresko struggled to formulate by how much natural gas and heating tariffs would increased this year (source: http://bbc.in/1LfohH7 in Ukrainian).

Sovereign debt restructuring: Worth cutting

This year, the economy should see another severe spike in public debt by 30% of GDP (in all-in-local-currency terms), i.e. from 40% in 2013, to slightly over 70% in 2014, and exceeding 100% in 2015.

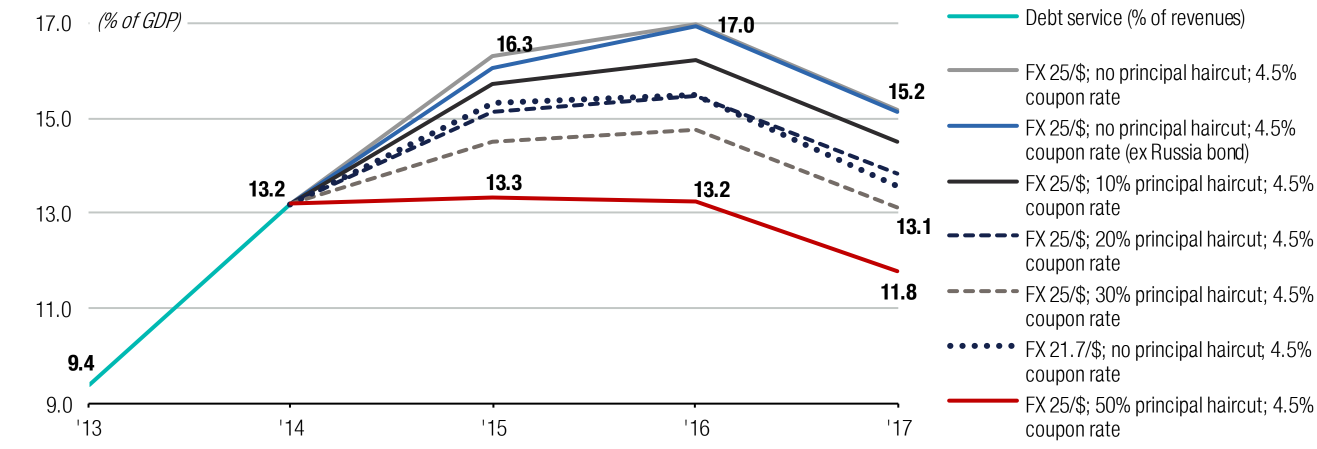
The opened talks between Ukraine's government and private external debt holders are likely to be tough and quite lengthy (notwithstanding the Russian US$3bn Eurobond due Dec-15). We summarized our assumptions regarding the scenarios of the debt restructuring and macro indicators in Table 6 on p.37. In our view, Ukraine's government will try to maximize its benefits in terms of debt servicing. This means that all Eurobonds are assumed to be considered for restructuring except for the US-back bond that already has a near 1% coupon rate could be excluded. The Russian bond could be considered as well, but the Kremlin ultimately will decide this. In our view, the coupon rate is likely to be reduced from the now effective 7.5% to 4.5%, which is the external debt servicing effective rate paid by Ukraine's government. Chart 40 shows debt servicing expenditures resulting from principal haircuts between 10% and 50%. Ukrainian authorities will most likely target debt service expenditure as a share of budget revenues to be unchanged from the previous year's 13.3%. To achieve this, private creditors will have to agree to a 50% principal haircut, the maximum.

Chart 39. Public debt level forecast under different scenarios (% of GDP) Details of the scenario are in the appendix, pp.61-84



Source: ICU.

Chart 40. Public debt level forecast under different scenarios (% of budget revenues) Details of the scenario are in the appendix, pp.61-84



Source: ICU.

Table 6. Key public debt indicators under 7 scenarios of external debt restructuring features and macro indicators pp.61-84

	2014	2015	2016	2017
Scenario 1 (Macro: average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH FX avg rate in 2015-17 is 25.25, 27, and 29.75. External debt restructuring: sovereign Eurobonds are restructured with total face value of US$16.2bn (this excludes the Eurobond backed by US government and includes the US$3bn Eurobond). New Eurobond details: fixed coupon rate 4.5%; redemption starts in 2021 by 15 equal installments each US$1.08bn a year. No principal haircut.)				
Public debt (% of GDP)	71.0	116.8	105.5	105.5
Public direct debt (% of GDP)	61.0	94.1	76.0	70.8
Debt service (% of GDP)	3.0	3.6	3.7	3.4
Debt service (% of revenues)	13.2	16.3	17.0	15.2
Scenario 2 (Macro: average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH FX avg rate in 2015-17 is 25.25, 27, and 29.75. External debt restructuring: sovereign Eurobonds are restructured with total face value of US$13.2bn (this excludes the US$1bn Eurobond backed by US government due in 2019 and the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed coupon rate 4.5%; redemption starts in 2021 by 15 equal installments each US$0.88bn a year. No principal haircut.)				
Public debt (% of GDP)	71.0	116.8	105.5	105.5
Public direct debt (% of GDP)	61.0	94.1	76.0	70.8
Debt service (% of GDP)	3.0	3.5	3.7	3.3
Debt service (% of revenues)	13.2	16.1	16.9	15.1
Scenario 3 (Macro: average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH FX avg rate in 2015-17 is 25.25, 27, and 29.75. External debt restructuring: sovereign Eurobonds are restructured with total face value of US$16.2bn (this excludes the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed coupon rate 4.5%; redemption starts in 2021 by 15 equal installments each US$0.97bn a year. 10% principal haircut.)				
Public debt (% of GDP)	71.0	114.6	103.5	103.8
Public direct debt (% of GDP)	61.0	91.9	74.0	69.1
Debt service (% of GDP)	3.0	3.5	3.6	3.2
Debt service (% of revenues)	13.2	15.7	16.2	14.5
Scenario 4 (Macro: average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH FX avg rate in 2015-17 is 25.25, 27, and 29.75. External debt restructuring: sovereign Eurobonds are restructured with total face value of US$16.2bn (this excludes the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed coupon rate 4.5%; redemption starts in 2021 by 15 equal installments each US$0.87bn a year. 20% principal haircut.)				
Public debt (% of GDP)	71.0	112.4	101.5	102.0
Public direct debt (% of GDP)	61.0	89.6	72.1	67.3
Debt service (% of GDP)	3.0	3.3	3.4	3.0
Debt service (% of revenues)	13.2	15.1	15.5	13.8
Scenario 5 (Macro: average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH FX avg rate in 2015-17 is 25.25, 27, and 29.75. External debt restructuring: sovereign Eurobonds are restructured with total face value of US$16.2bn (this does exclude the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed coupon rate 4.5%; redemption starts in 2021 by 15 equal installments each US$0.76bn a year. 30% principal haircut.)				
Public debt (% of GDP)	71.0	110.2	99.6	100.2
Public direct debt (% of GDP)	61.0	87.4	70.1	65.5
Debt service (% of GDP)	3.0	3.2	3.3	2.9
Debt service (% of revenues)	13.2	14.5	14.7	13.1
Scenario 6 (Macro: average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH FX rate in 2015-17 is 21.7. External debt restructuring: sovereign Eurobonds are restructured with total face value of US$16.2bn (this does exclude the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed coupon rate 4.5%; redemption starts in 2021 by 15 equal installments each US$1.08bn a year. No principal haircut.)				
Public debt (% of GDP)	71.0	104.3	90.8	87.0
Public direct debt (% of GDP)	61.0	85.1	67.6	61.5
Debt service (% of GDP)	3.0	3.4	3.4	3.0
Debt service (% of revenues)	13.2	15.3	15.5	13.5
Scenario 7 (Macro: average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH FX avg rate in 2015-17 is 25.25, 27, and 29.75. External debt restructuring: sovereign Eurobonds are restructured with total face value of US$16.2bn (this does exclude the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed coupon rate 4.5%; redemption starts in 2021 by 15 equal installments each US$0.76bn a year. 50% principal haircut.)				
Public debt (% of GDP)	71.0	105.7	95.6	96.6
Public direct debt (% of GDP)	61.0	83.0	66.1	62.0
Debt service (% of GDP)	3.0	2.9	2.9	2.6
Debt service (% of revenues)	13.2	13.3	13.2	11.8

Source: ICU.

Prices, monetary conditions: A vicious cycle

In our view, the economy has been in a vicious cycle since early 2014.

It began with extremely low creditworthiness of a government that itself runs on an overestimated assumption of future GDP growth and high budget receipts amidst a gaping budget deficit and previously unaccounted issues becoming urgent, hence requiring budget financing (i.e. Naftogaz and banking recapitalizations). As financier of last resort, the central bank bows to state needs by providing QE support, confirming that public debt is not going to stabilize any time soon. As official FX reserves have been dwindling, the private sector, out of fear, naturally will revert to a run on currency and capital flight if capital controls allow. Currency devaluation follows, forcing businesses to pass increased costs on to customers, assuring double-digit inflation. At the same time, authorities' efforts to secure IMF assistance to address Naftogaz's and the banking sector's fundamental issue of lost revenues continue, sovereign risk remains an issue and the above-mentioned developments complete the cycle again. Thus, the government's low creditworthiness remains intact, assumptions of growth and budget receipts remain overly optimistic, and debt to be financed by the government returns again.

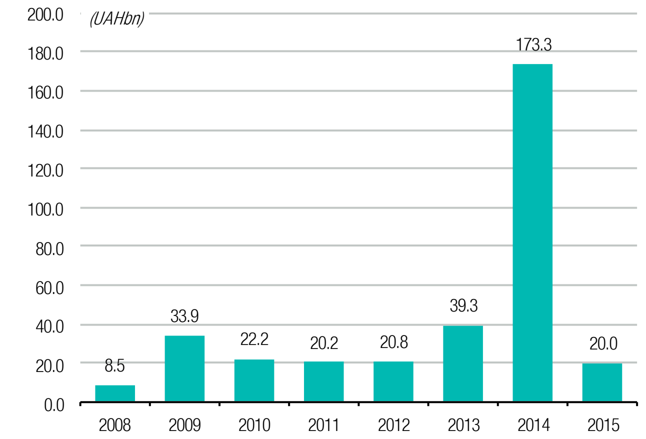
With new efforts by the IMF to stabilize Ukraine's economy through its Extended Fund Facility program this March, the vicious cycle might not be over. If Ukraine's authorities don not decisively rectify Natfogaz or the banking sector, an overly timid approach could not only prolong any revitalization of these areas but also result in more vicious cycles.

That being said, the inflation phenomena since last year is a result not of the tariff increase (which is expected to be gradual) but because authorities are afraid to implement the severe reforms necessary to fix Naftogaz and the insolvent banks. Because these institutions are such a drain of public funds, the large deficit will continue to require more QE from the NBU.

Our base-case scenario envisage this, yielding an average CPI inflation of 29.0% YoY in full-year 2015 and 25.1% YoY in December 2015. In 2016, average and year-end CPI is forecast at 17.9% YoY and 16.4% YoY, respectively.

Chart 41. Net increase in the stock of domestic government securities held by central bank NBU (UAHbn)

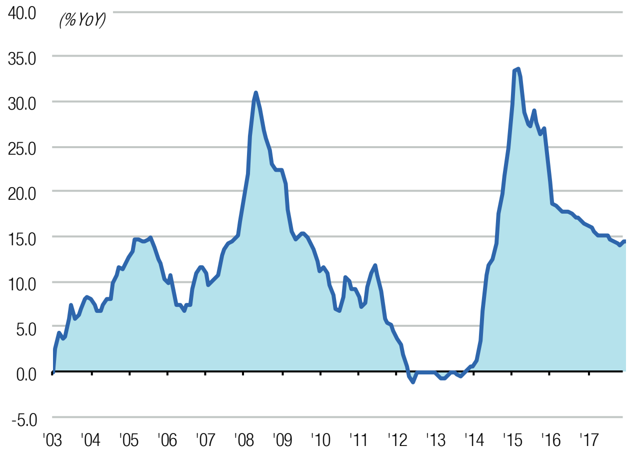
Yearly history from 2008 through 2014. For 2015, the data is from 1 January through 4 March



Source: National Bank of Ukraine, ICU.

Chart 42. Headline CPI history 2003-14 and forecast 2015-17 (% YoY)

Monthly history from January 2003 through January 2015 and forecast for the rest of 2015 and the 2016-17 period



Source: State Statistics Service of Ukraine, ICU.

External balance: In the emergency

Due to contracted domestic demand following the severely devalued currency, the current account deficit is expected to narrow in nominal terms – from US$5.2bn in 2014 to US$2.2bn in 2015 and US$0.9bn in 2016, and rebound in 2017 to US$2.5bn on the back of projected real GDP growth of near 3%. At the same time, because of the dramatic US dollar-value decline of the economy, the current account deficit is forecast to decline to just 3.5% of GDP from 4.0% in 2014. In 2016, it falls to 1.2%. See Chart 43 on p.39.

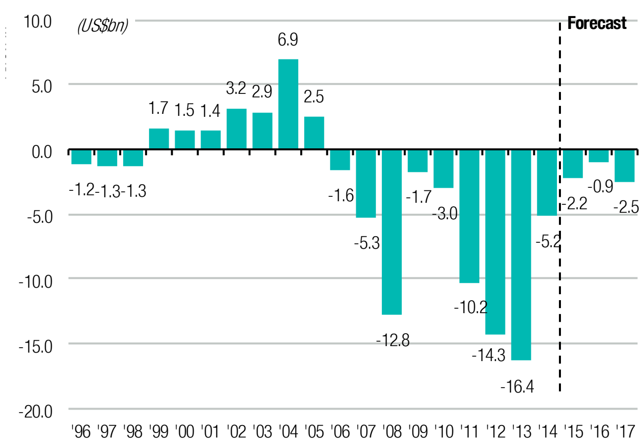
In regard to exports, the weak commodity markets and future expectations of US dollar strength indicate no rebound in commodity prices going forward. Moreover, the current pace of the uneven global economy where regional economies that neighbor Ukraine are stagnant, external demand for Ukrainian exports could remain weak, promising no quick recovery of exports from Ukraine.

Aside from imports and exports, Ukraine's balance of payments deteriorated dramatically. Chart 44 (on p.40) shows the decline of direct investments into the country to just US$0.4bn (0.3% of GDP) in full-year 2014 from US$4.1bn a year ago. The capital flight from the country (under the BoP item of "Other capital") accelerated to US$6.4bn or 4.9% of GDP, the highest volume since 2010. Net external borrowing by banks and corporations in 2014 redeemed more external debt than they borrowed, deleveraging at a high pace. The rollover ratio for banks in aggregate dropped to 47.4% (for full-year 2014), while that for corporations collapsed to 42.9% (for the last 12 months through December 2014).

The shape of the future financial account in 2015-18 (the four year period matches the IMF's Extended Fund Facility program length) is the key to Ukraine's external balance. Below are scenarios for FX reserve volumes in the upcoming three-year forecast.

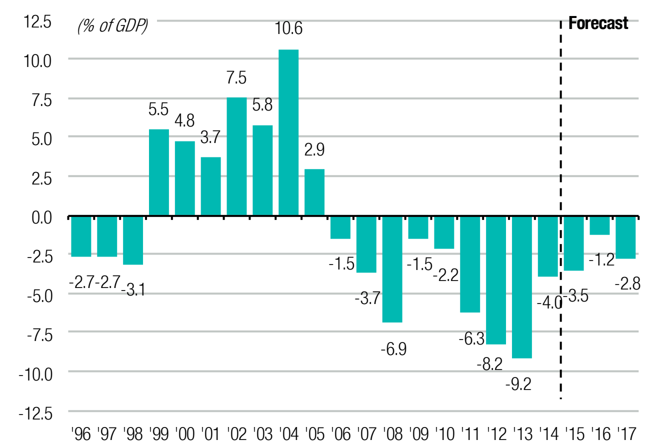
Chart 43. Ukraine's current account balance – 1996-2014 history and 2015-17 forecast

Nominal volume is billions of US dollars



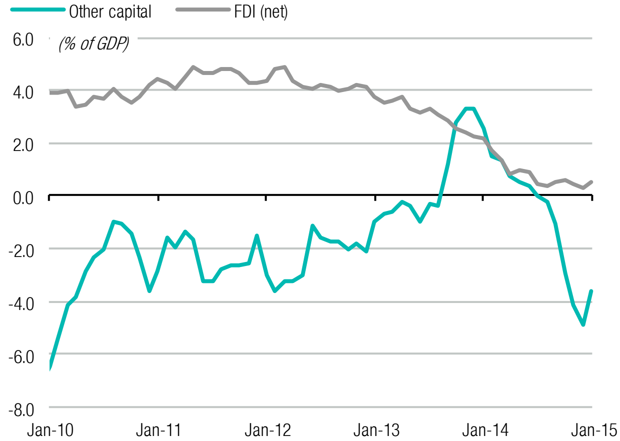
Source: National Bank of Ukraine, ICU.

As percentage share of GDP

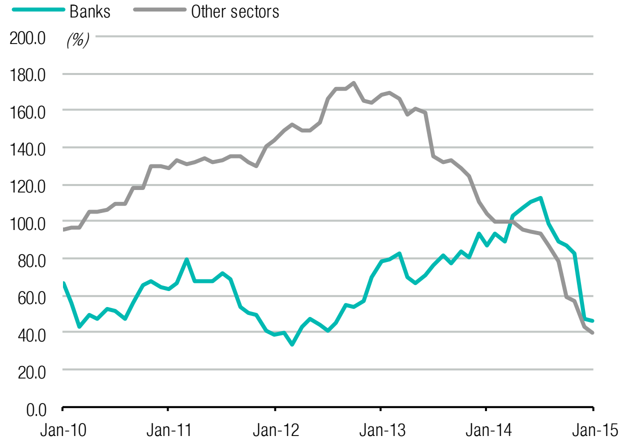


Source: National Bank of Ukraine, ICU.

Chart 44. Net FDI and other capital (% of GDP, left) and rollover ratio* for external borrowings by banks and other sectors (%, right)



Source: National Bank of Ukraine, ICU.



Note: >100% means leveraging by the sector; <100% means deleveraging by the sector. Source: National Bank of Ukraine, ICU.

Here are the following assumptions:

First, external financing in 2015-18 includes the IMF and other donor funding, namely China (Table 7, p.42). It amounts to US$25.5bn without China's financing (FX swap line and a loan for energy efficiency) and US$31.5bn if China's financing is factored in.

Second, the variable that determines how much external debt to private creditors is being restructured beyond 2015-18 has three options: 1) Sovereign Eurobonds only; 2) Sovereign and quasi-sovereign Eurobonds and private sector Eurobonds; 3) same as second option but excluding the US$3bn Russian Eurobond due in December 2015.

Third, the variable that determines the rollover ratios for external borrowings by the banking and corporate sectors has three options:

1) A comfortable option: in 2015, the ratios recover from the 2014 year end trough, when they collapsed just below 50% in the last 12 month period through January 2015, towards the 2014 yearly average of 89% and 79%[18] , respectively (see right-hand part of Chart 44 on p.40); from 2016, these ratios are assumed at 100%;

2) An option of severe distress: in 2015, the ratios remain at the previous year's bottom of 50% for both the banking and corporate sectors, and recover to 75% in 2016 and 100% in 2017;

3) An option of gradual recovery: rollover ratios for banks and corporations recover to 81% and 65% in 2015, then 95% and 85% in 2016, and 100% in 2017-18.

Our conclusion is depicted on Chart 45 on p.41 summarizes the data provided by FX reserves volume in 2015-18 under the above-mentioned scenarios.

Thus, Table 14 on p.56 is built under the assumptions that external financing is US$31.5bn, Eurobond restructuring is by the first option and rollover ratios are by the first option.

Table 15 on p.57 – external financing is US$31.5bn, Eurobond restructuring is by the second option and rollover ratios are by the first option.

[18] These are measured as monthly average of the rollover ratios, which calculated on a 12-month rolling basis, ie January 2014 rollover ratios are based upon the external debt data from February 2013 through January 2014.

Table 16 on p.58 – external financing is US$31.5bn, Eurobond restructuring is by the second option and rollover ratios are by the first option.

Table 17 on p.59 – external financing is US$31.5bn, Eurobond restructuring is by the second option and rollover ratios are by the third option.

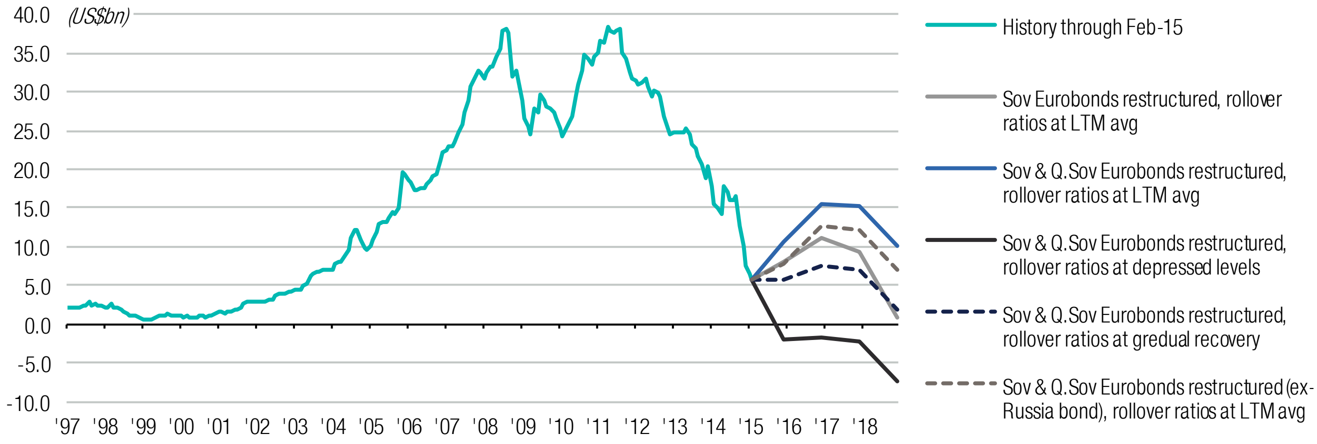
Table 18 on p.60 – external financing is US$31.5bn, Eurobond restructuring is by third option and rollover ratios are by first option.

The scenario when rollover ratios in 2015 do not recover from the 2014 trough is the most stressful as the economy runs out of FX reserves in 2015 even if all Eurobonds due in 2015-18 are restructured beyond the period.

Also, the scenario when all Eurobonds are pushed beyond 2018 and the rollover ratio does recover albeit at a moderate pace—banks recover from 47% to 81% and corporations from 43% to 65%—the impact on FX reserves is more negative than under the scenario when only sovereign Eurobonds are restructured (the rest are redeemed) and the rollover ratio recovers to 89% and 79%, respectively, for banks and corporations.

Hence, in our view, for authorities to restore macroeconomic stability, it is not only vital to restructure the Eurobond stock but also to increase rollover ratios by banks and corporations. The latter could be done realistically via tight capital controls.

Chart 45. FX reserves history and projections into 2015-18 under three scenarios (US$bn)



Source: National Bank of Ukraine, ICU.

Table 7. Projections of arrival of committed financing by IMF and other western donors and probable financing from China (US$m)

	2015	2016	2017	2018	Total
To Ukraine's government					
IMF	2,000				2,000
Other donors (EU, WB, EBRD, Japan, etc)	5,880				5,880
Eurobonds backed by US govt	2,000				2,000
To Ukraine's central bank					
IMF	8,000	4,400	3,200		15,600
China financing (FX swap, loans)		4,240	1,800		6,040
FX swap		2,440			2,440
Loans*		1,800	1,800		3,600
Total financing, excluding China	**17,880**	**4,400**	**3,200**	**0**	**25,480**
Total financing, with China	**17,880**	**8,640**	**5,000**	**0**	**31,520**

Notes: * assumed the loans that were
Sources: Company data.

UAH: Undergoing protracted distress

In our view, the hryvnia found itself under tremendous distress after recent moves in the FX market, when panicked demand for FX swelled the hryvnia's market rate into record high misalignment territory. The right-hand chart below shows that the recent drop in the exchange rate to 31/USD implies a 50% negative misalignment of the market rate from the fundamental (fair-value) rate. In the 2008-09 crisis, the market exchange rate of the hryvnia had negative misalignment of 40% at the peak of sell-off and then recovered.

According to our observations of the FX misalignment by the real trade-weighted indices, the most distressed currencies like the Russian ruble (in December 2014), the Belarusian ruble (in October 2011) and the Venezuelan bolivar (in October 2010) had their own peaks of negative misalignment. These peaks were at 30-40%, respectively.

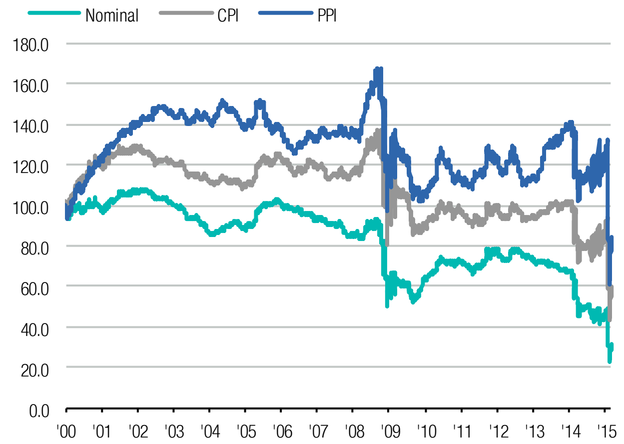
This suggests that the UAH too has its own peak in negative misalignment – it was just recently pushed up to 50% from the previous peak of 40% in the 2008-09 crisis. Indeed, the current conditions could push the UAH rate to a negative misalignment of 60%. However, such peaks of negative misalignment have always been short-lived, being eliminated by inflation, a market rebound (appreciation), or by these two factors being playing out simultaneously.

We foresee the Ukrainian hryvnia remaining in distress with protracted negative misalignment that should shrink over time mainly because of inflation. The market rate should stay at 25/USD as authorities deploy rigid administrative measures that enable them to spend less on FX market interventions while avoiding a deeper negative misalignment.

Indeed, the hryvnia now stands deeply undervalued by our two in-house preferred measures – by the real trade-weighted indices and by the consumer basket comparison (see appendix "ICU consumer basket: Observation of Kiev, New-York and Moscow prices", p.52).

Chart 46. UAH's trade-weighted indices (TWIs)

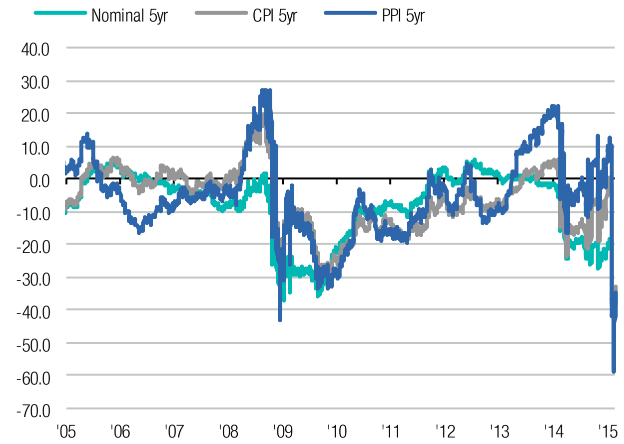
Daily history from 1 January 2000 through 3 March 2015



Source: ICU.

Chart 47. UAH's misalignment by TWIs

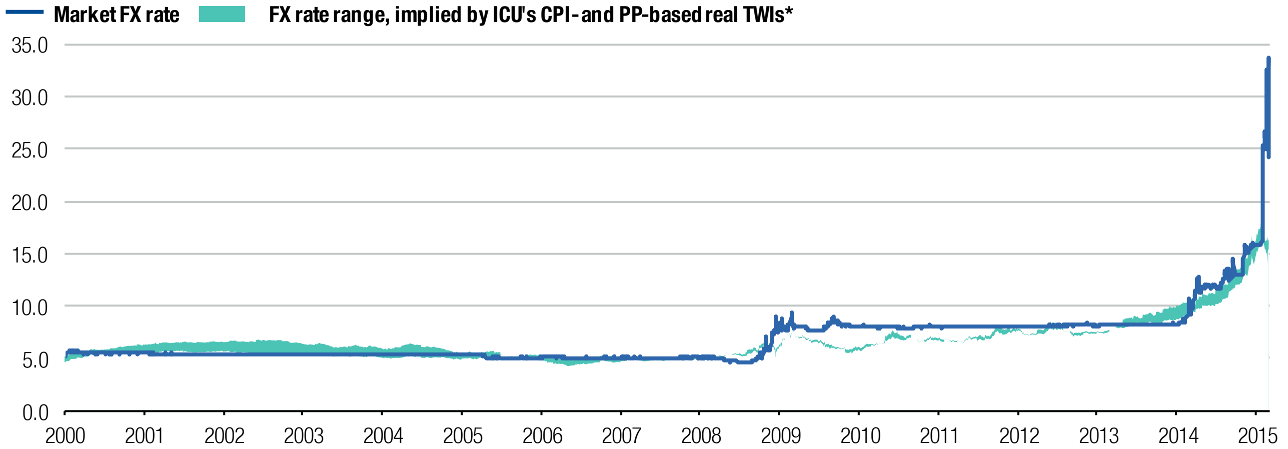
Daily history from 1 January 2000 through 3 March 2015



Source: ICU.

Chart 48. USD/UAH market exchange rate on the background of the fundamental (fair-value) range as implied by real TWIs

Daily history from 1 January 2000 through 3 March 2015



Source: Bloomberg, ICU.

Forecast for 2015-17

The following two pages of statistics provide ICU's detailed view on future key macroeconomic indicators in yearly and quarterly perspectives.

Yearly forecast for 2015-17, base-case scenario

Table 8. Forecast of key macroeconomic indicators for 2015-17 (annual)

	Historical data for 2004-12										Forecast by ICU		
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014E	2015F	2016F	2017F
Activity													
Real GDP (%YoY)	2.7	7.3	7.9	2.3	-14.8	4.1	5.2	0.2	-0.1	-6.7	-7.6	0.0	2.6
Nominal GDP (UAHbn)	441	544	721	948	913	1,083	1,302	1,409	1,455	1,551	1,903	2,298	2,745
Nominal GDP (US$bn)	87	108	143	184	114	136	163	174	178	130	75	85	92
GDP per capita (US$, ann)	1,850	2,319	3,091	3,986	2,474	2,978	3,572	3,823	3,920	3,017	1,745	1,978	2,156
Unemployment rate (%)	7.2	6.2	6.4	6.4	8.8	8.1	7.9	7.5	7.2	8.7	10.8	9.7	9.7
Prices													
CPI headline (%YoY, eop)	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	25.1	16.4	14.5
CPI headline (%YoY, average)	13.6	9.1	12.8	25.3	16.0	9.4	8.0	0.6	-0.3	12.1	29.0	17.9	15.0
PPI (%YoY, eop)	9.6	15.4	23.2	21.1	15.3	18.8	17.4	0.4	1.7	31.8	28.1	19.6	16.4
PPI (%YoY, average)	17.0	9.6	20.5	33.6	7.4	21.4	19.9	6.0	-0.1	17.0	29.8	23.5	17.9
Fiscal balance													
Consolidated budget bal. (UAHbn)	-7.5	-3.5	-6.1	-11.3	-34.4	-63.3	-18.3	-46.9	-63.0	-67.1	-130.7	-50.3	-42.9
Consolidated budget bal. (% of GDP)	-1.7	-0.6	-0.8	-1.2	-3.8	-5.9	-1.4	-3.3	-4.3	-4.3	-6.9	-2.2	-1.6
Budget balance (UAHbn)	-7.9	-3.8	-9.8	-12.5	-35.5	-64.3	-23.6	-53.4	-64.7	-78.1	-142.6	-83.7	-85.7
Budget balance (% of GDP)	-1.8	-0.7	-1.4	-1.3	-3.9	-5.9	-1.8	-3.8	-4.4	-5.0	-7.5	-3.6	-3.1
External balance													
Exports (US$bn)	44.4	50.2	64.0	85.6	54.3	69.3	88.8	90.0	85.3	68.8	58.3	59.0	61.2
Imports (US$bn)	43.7	53.3	72.2	100.0	56.2	73.2	99.0	104.4	100.8	74.1	61.0	60.4	64.2
Trade balance (US$bn)	0.7	-3.1	-8.2	-14.4	-2.0	-4.0	-10.2	-14.3	-15.5	-5.3	-2.7	-1.4	-3.1
Trade balance (% of GDP)	0.8	-2.8	-5.7	-7.8	-1.7	-2.9	-6.2	-8.2	-8.7	-4.1	-3.6	-1.7	-3.3
Current account balance (US$bn)	2.5	-1.6	-5.3	-12.8	-1.7	-3.0	-10.2	-14.3	-16.4	-5.2	-2.3	-1.0	-2.5
Current account balance (% of GDP)	2.9	-1.5	-3.7	-6.9	-1.5	-2.2	-6.3	-8.2	-9.2	-4.0	-3.1	-1.2	-2.8
Net FDI (US$bn)	7.5	5.7	9.2	9.9	4.7	5.8	7.0	7.2	4.1	0.4	1.0	2.4	2.4
Net FDI (% of GDP)	8.7	5.3	6.4	5.4	4.1	4.2	4.3	4.1	2.3	0.3	1.3	2.8	2.6
C/A bal. + net FDI (% of GDP)	11.6	3.8	2.8	-1.6	2.6	2.0	-2.0	-4.1	-6.9	-3.7	-1.8	1.6	-0.1
External debt (US$bn, eop)	39.6	54.5	80.0	101.7	103.4	117.3	126.2	134.6	142.1	134.1	139.1	143.0	143.3
External debt (% of ann'd GDP, eop)	45.6	50.4	55.8	55.3	90.9	86.1	77.4	77.3	79.7	103.1	184.8	168.4	155.6
FX reserves (US$bn, eop)	19.4	22.3	32.5	31.5	26.5	34.6	31.8	24.5	20.4	7.5	10.7	15.6	15.2
FX reserves (% of ann'd GDP, eop)	22.3	20.6	22.6	17.2	23.3	25.4	19.5	14.1	11.4	5.8	14.2	18.3	16.5
External debt / FX reserves (x, eop)	2.0	2.4	2.5	3.2	3.9	3.4	4.0	5.5	7.0	17.8	13.0	9.2	9.4
FX reserves imports cov (months)	5.3	5.0	5.4	3.8	5.7	5.7	3.9	2.8	2.4	1.2	2.1	3.1	2.8
Interest rates													
Central bank key rate (%, eop)	9.50	8.50	8.00	12.00	10.25	7.75	7.75	7.50	6.50	14.00	30.00	20.00	15.00
3-month rate (%, eop 4Q)	11.46	9.90	7.58	21.60	17.59	6.12	19.72	25.52	11.71	18.37	30.00	25.00	25.00
Exchange rates													
UAH trade-weighted index (nominal)	77.84	70.90	64.93	45.89	46.09	53.28	56.87	54.63	49.59	32.62	19.65	19.48	18.95
UAH trade-weighted index (real)	129.21	123.61	120.06	100.21	90.26	97.73	98.76	94.72	100.84	84.90	59.45	64.46	67.40
UAH/US$ (eop)	5.05	5.05	5.05	7.80	8.00	7.94	8.00	8.05	8.24	14.45	26.00	28.00	30.00
UAH/US$ (average)	5.10	5.03	5.03	5.25	8.03	7.94	7.99	8.08	8.16	12.00	25.25	27.00	29.75
UAH/€ (eop)	5.97	6.66	7.36	10.90	11.45	10.63	10.37	10.62	11.32	18.06	28.60	33.60	36.30
UAH/€ (average)	6.05	6.64	7.32	7.10	11.70	10.51	10.50	10.60	11.17	15.95	27.84	30.38	35.92
US$/€ (eop)	1.18	1.32	1.46	1.40	1.43	1.34	1.30	1.32	1.37	1.25	1.10	1.20	1.21
US$/€ (average)	1.19	1.32	1.46	1.35	1.46	1.32	1.32	1.31	1.37	1.33	1.10	1.13	1.21
Population													
Population (million, eop)	47.0	46.6	46.4	46.1	46.0	45.8	45.6	45.6	45.5	43.1	43.1	42.9	42.7
Population (%YoY)	-0.8	-0.7	-0.6	-0.5	-0.4	-0.4	-0.3	-0.2	-0.1	-5.2	0.0	-0.5	-0.5

Notes: eop – end of period; cov – coverage; con'd – consolidated; ann – annualised. Sources: State Statistics Service of Ukraine, NBU, ICU.

Quarterly forecast for 2015-17, base-case scenario

Table 9. Forecast of key macroeconomic indicators for 2014-16 (quarterly)

	Forecast by ICU											
	1Q15F	2Q15F	3Q15F	4Q15F	1Q16F	2Q16F	3Q16F	4Q16F	1Q17F	2Q17F	3Q17F	4Q17F
Activity												
Real GDP (%YoY)	-13.0	-10.0	-8.0	1.2	1.0	0.0	1.0	-2.0	2.0	2.5	3.0	2.8
Nominal GDP (UAHbn)	375.9	448.8	518.5	560.2	467.9	546.1	629.5	655.1	561.2	653.4	752.6	777.5
Nominal GDP (US$bn)	20.3	18.0	20.7	21.5	18.0	20.2	23.3	23.4	19.4	21.8	25.1	25.9
GDP per capita (US$, ann)	2,694	2,376	2,069	1,871	1,818	1,873	1,936	1,981	2,015	2,054	2,098	2,160
Unemployment rate (%)	9.6	10.6	10.9	10.8	10.9	9.7	9.7	9.7	9.7	9.7	9.7	9.7
Prices												
CPI headline (%YoY, eop)	33.6	27.5	27.7	25.1	18.4	17.9	17.2	16.4	15.6	15.1	14.5	14.5
CPI headline (%YoY, average)	32.2	29.7	28.0	26.2	19.4	17.9	17.5	16.7	16.0	15.2	14.8	14.2
PPI (%YoY, eop)	30.9	30.0	29.0	28.1	26.0	23.8	21.7	19.6	18.8	18.0	17.2	16.4
PPI (%YoY, average)	31.2	30.3	29.3	28.4	26.7	24.6	22.4	20.3	19.1	18.3	17.5	16.7
Fiscal balance												
Consolidated budget bal. (UAHbn)	-26.1	-36.9	-23.4	-44.3	-7.0	-17.7	0.0	-25.6	-4.4	-16.6	4.6	-26.6
Consolidated budget bal. (% of GDP)	-6.9	-8.2	-4.5	-7.9	-1.5	-3.2	0.0	-3.9	-0.8	-2.5	0.6	-3.4
Budget balance (UAHbn)	-28.1	-38.4	-28.7	-47.4	-14.0	-24.2	-11.5	-34.0	-13.5	-25.3	-9.9	-37.1
Budget balance (% of GDP)	-7.5	-8.5	-5.5	-8.5	-3.0	-4.4	-1.8	-5.2	-2.4	-3.9	-1.3	-4.8
External balance												
Exports (US$bn)	15.1	14.3	14.7	14.2	14.8	14.4	15.0	14.8	15.2	14.8	15.5	15.7
Imports (US$bn)	16.4	14.1	15.5	15.1	14.4	14.0	16.0	16.1	15.6	15.1	16.9	16.7
Trade balance (US$bn)	-1.3	0.2	-0.7	-0.9	0.4	0.4	-1.0	-1.2	-0.4	-0.3	-1.3	-1.0
Trade balance (% of GDP)	-6.3	1.2	-3.6	-4.2	2.1	2.0	-4.3	-5.3	-1.9	-1.4	-5.3	-4.0
Current account balance (US$bn)	-1.2	0.3	-0.8	-0.6	0.5	0.5	-0.9	-1.0	-0.3	-0.2	-1.2	-0.8
Current account balance (% of GDP)	-5.9	1.5	-3.7	-3.0	2.6	2.5	-4.0	-4.3	-1.3	-0.9	-5.0	-3.3
Net FDI (US$bn)	0.1	0.3	0.3	0.3	0.6	0.8	0.5	0.5	0.6	0.7	0.6	0.6
Net FDI (% of GDP)	0.5	1.7	1.4	1.4	3.3	4.0	2.2	2.0	2.9	3.1	2.4	2.2
C/A bal. + net FDI (% of GDP)	-5.4	3.2	-2.3	-1.6	6.0	6.5	-1.9	-2.4	1.6	2.2	-2.6	-1.0
External debt (US$bn, eop)	135.4	136.7	137.9	139.1	140.1	141.1	142.0	143.0	143.3	143.3	143.3	143.3
External debt (% of ann'd GDP, eop)	116.7	133.5	154.7	172.6	179.0	175.2	171.0	168.4	166.1	163.2	159.9	155.6
FX reserves (US$bn, eop)	8.3	9.1	9.9	10.7	11.9	13.1	14.4	15.6	15.5	15.4	15.3	15.2
FX reserves (% of ann'd GDP, eop)	7.2	8.9	11.1	13.3	15.2	16.3	17.3	18.3	17.9	17.5	17.1	16.5
External debt / FX reserves (x, eop)	16.3	15.0	13.9	13.0	11.7	10.7	9.9	9.2	9.3	9.3	9.4	9.4
FX reserves imports cov (months)	1.4	1.7	1.9	2.1	2.4	2.7	2.9	3.1	3.0	2.9	2.9	2.8
Interest rates												
Central bank key rate (%, eop)	30.00	30.00	30.00	30.00	25.00	25.00	25.00	20.00	15.00	15.00	15.00	15.00
3-month rate (%, eop 4Q)	20.22	28.00	30.00	30.00	25.00	25.00	25.00	18.00	18.00	18.00	18.00	18.00
Exchange rates												
UAH trade-weighted index (nominal)	19.38	19.36	19.88	19.65	19.59	19.52	19.54	19.48	19.50	19.48	19.50	18.95
UAH trade-weighted index (real)	52.14	55.40	58.44	59.45	60.35	63.04	63.79	64.46	65.42	68.19	68.71	67.40
UAH/US$ (eop)	0.00	25.00	25.00	26.00	26.00	27.00	27.00	28.00	29.00	30.00	30.00	30.00
UAH/US$ (average)	18.48	25.00	25.00	26.00	26.00	27.00	27.00	28.00	29.00	30.00	30.00	30.00
UAH/€ (eop)	0.00	27.50	27.50	28.60	28.60	29.70	29.70	33.60	34.80	36.30	36.30	36.30
UAH/€ (average)	21.43	27.63	27.50	28.60	28.60	29.70	29.70	32.20	34.80	36.15	36.30	36.30
US$/€ (eop)	1.11	1.10	1.10	1.10	1.10	1.10	1.10	1.20	1.20	1.21	1.21	1.21
US$/€ (average)	1.16	1.11	1.10	1.10	1.10	1.10	1.10	1.15	1.20	1.21	1.21	1.21
Population												
Population (million, eop)	43.16	43.01	42.99	43.14	42.95	42.80	42.79	42.94	42.74	42.59	42.58	42.73
Population (%YoY)	0.0	0.0	0.0	0.0	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5

Notes: eop – end of period; cov – coverage; con'd – consolidated; ann – annualised. Sources: State Statistics Service of Ukraine, NBU, ICU.

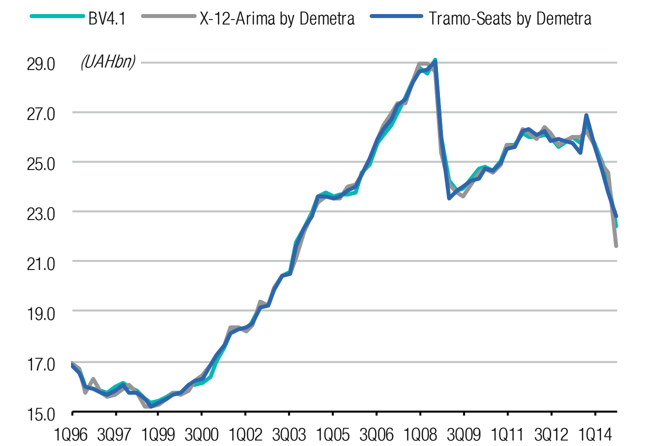
Appendices: Research details, thematic charts & tables

The following pages contain the details charted and tabled data for the appropriate sections in this report.

Quarterly GDP: Reported statistics and ICU's calculations

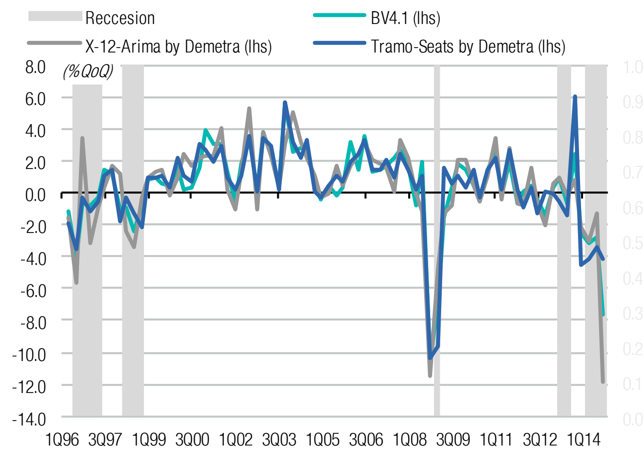
Chart 49. Ukraine's economy from the perspective of quarterly GDP volumes (left) and on-quarter growth rates (right)
History from 1Q96 till 4Q14
Data is adjusted for inflation and seasonal factors. data is seasonally adjusted by three methods BV4.1, X-12 Arima and Tramo-Seats

Quarterly GDP size in constant prices of Dec-95



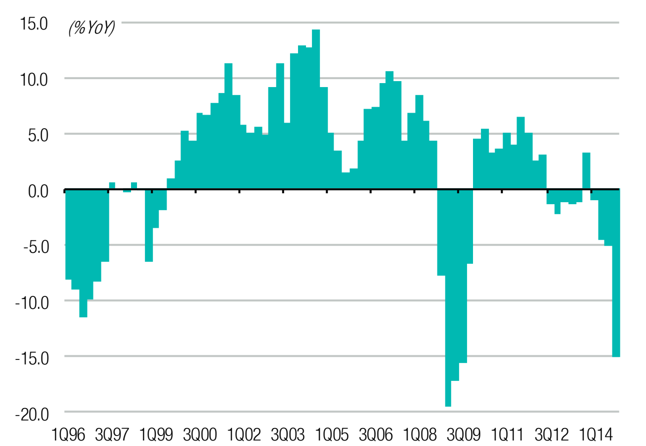
Sources: State Statistics Service of Ukraine, Investment Capital Ukraine LLC.

Quarterly GDP growth rates (% QoQ)



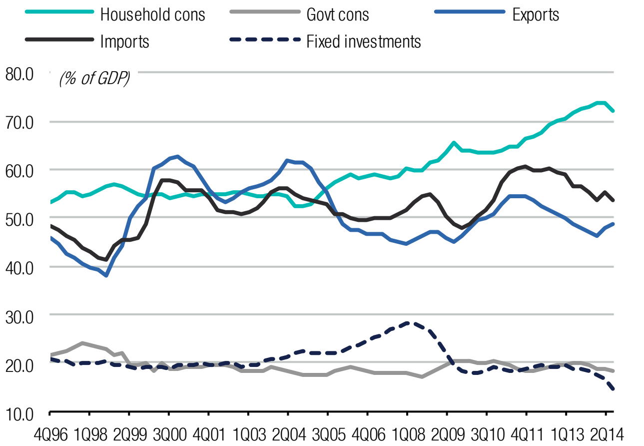
Sources: State Statistics Service of Ukraine, Investment Capital Ukraine LLC.

Chart 50. Reported on-year quarterly GDP growth (% YoY)
History from 1Q 1996 till 2Q 2014



Source: State Statistics Service of Ukraine.

Chart 51. Demand-side components of GDP (% of total, LTM)
History from 4Q 1996 till 4Q 2013



Source: State Statistics Service of Ukraine, Investment Capital Ukraine LLC.

Table 10. Ukraine quarterly GDP size: History from 4Q96 till 4Q14 (UAHm, if not otherwise indicated)
Reported statistics and ICU calculations of quarter-on-quarter growth in real and seasonally-adjusted terms

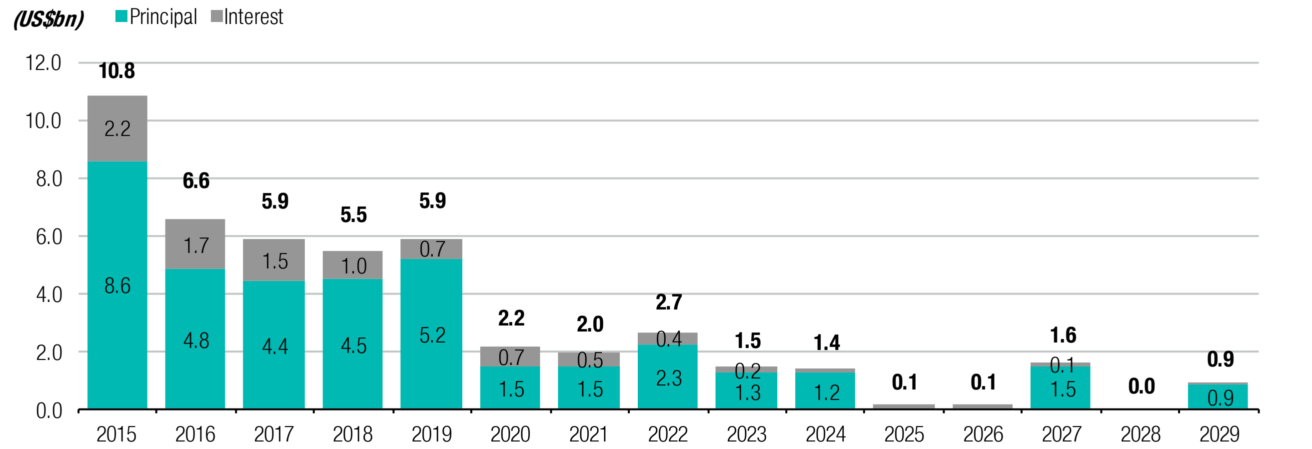
Period	Reported statistics on quarterly GDP				ICU calculations							
							GDP at cons prices[1] (UAHm, SA)			Real GDP growth (%QoQ, SA)		
	GDP at current prices (UAHm)	Real growth (% YoY, qtly)	Real growth (% QoQ, SA)	Deflator (% YoY)	Real growth (% YoY, ann'd)	GDP at cons prices[1] (UAHm, NSA)	BV4.1	X-12-Arima by Demetra	Tramo-Seats by Demetra	BV4.1	X-12-Arima by Demetra	Tramo-Seats by Demetra
4Q96	24,454	-10.0		40.1	-9.7	17,404	16,075	16,228	**15,824**	0.8	4.6	0.8
1Q97	18,728	-8.3		22.3	-9.8	14,114	15,777	15,780	**15,779**	-1.9	-2.8	-0.3
2Q97	20,485	-6.6		22.7	-9.1	14,117	15,758	15,586	**15,750**	-0.1	-1.2	-0.2
3Q97	26,076	0.5		15.3	-6.2	17,544	16,049	15,531	**15,687**	1.8	-0.4	-0.4
4Q97	28,076	0.0		14.8	-3.7	17,405	16,122	16,258	**15,984**	0.5	4.7	1.9
1Q98	20,871	-0.3		11.8	-1.6	14,068	16,011	15,744	**15,762**	-0.7	-3.2	-1.4
2Q98	23,367	0.5		13.5	0.2	14,188	15,795	15,701	**15,724**	-1.4	-0.3	-0.2
3Q98	28,908	-0.1		10.9	0.0	17,538	15,379	15,435	**15,479**	-2.6	-1.7	-1.6
4Q98	29,447	-6.6		12.3	-1.7	16,256	15,177	15,236	**15,165**	-1.3	-1.3	-2.0
…	…	…	…	…	…	…	…	…	**…**	…	…	**…**
4Q06	159,080	9.6		12.8	7.1	27,659	26,114	26,470	**26,341**	1.3	2.1	1.5
1Q07	139,444	10.6		18.6	8.7	24,253	26,487	26,954	**26,734**	1.4	1.8	1.5
2Q07	166,869	9.7		20.4	9.3	25,260	26,947	27,377	**27,293**	1.7	1.6	2.1
3Q07	199,535	4.4		25.4	8.5	30,592	27,550	27,383	**27,539**	2.2	0.0	0.9
4Q07	214,883	6.9		26.4	7.9	29,558	28,275	28,305	**28,218**	2.6	3.4	2.5
1Q08	191,459	8.5		26.6	7.4	26,303	28,755	28,933	**28,642**	1.7	2.2	1.5
2Q08	236,033	6.2		33.2	6.5	26,824	28,524	28,910	**28,697**	-0.8	-0.1	0.2
3Q08	276,451	4.3		32.9	6.5	31,892	29,068	28,590	**29,011**	1.9	-1.1	1.1
4Q08	244,113	-7.8		23.3	2.6	27,233	25,995	25,322	**25,990**	-10.6	-11.4	-10.4
1Q09	189,028	-19.6		22.8	-4.8	21,148	24,212	24,109	**23,506**	-6.9	-4.8	-9.6
2Q09	214,103	-17.3		9.7	-10.6	22,181	23,827	23,797	**23,865**	-1.6	-1.3	1.5
3Q09	250,306	-15.7		7.4	-15.2	26,886	23,899	23,602	**24,017**	0.3	-0.8	0.6
4Q09	259,908	-6.7		14.1	-15.0	25,412	24,346	24,097	**24,273**	1.9	2.1	1.1
1Q10	217,286	4.5	0.7	10.7	-9.2	21,959	24,710	24,593	**24,348**	1.5	2.1	0.3
2Q10	256,754	5.4	1.4	15.1	-3.5	23,110	24,809	24,715	**24,698**	0.4	0.5	1.4
3Q10	301,251	3.3	0.4	17.5	1.5	27,539	24,666	24,595	**24,615**	-0.6	-0.5	-0.3
4Q10	307,278	3.7	0.7	15.6	4.2	25,989	25,030	24,846	**24,963**	1.5	1.0	1.4
1Q11	257,682	5.1	2.0	12.9	4.4	23,066	25,676	25,709	**25,525**	2.6	3.5	2.3
2Q11	311,022	3.9	0.3	16.6	4.0	24,009	25,644	25,617	**25,570**	-0.1	-0.4	0.2
3Q11	369,818	6.5	2.5	15.2	4.8	29,347	26,132	26,343	**26,272**	1.9	2.8	2.7
4Q11	363,557	5.0	0.3	12.6	5.1	27,309	25,962	26,153	**26,331**	-0.7	-0.7	0.2
1Q12	293,493	2.5	-0.8	11.4	4.5	23,584	25,994	25,933	**26,107**	0.1	-0.8	-0.9
2Q12	349,212	3.1	0.5	9.0	4.3	24,731	26,110	26,355	**26,199**	0.4	1.6	0.4
3Q12	387,620	-1.3	-1.5	6.2	2.3	28,963	26,002	26,168	**25,858**	-0.4	-0.7	-1.3
4Q12	378,564	-2.3	-0.8	6.6	0.5	26,681	25,635	25,652	**25,883**	-1.4	-2.0	0.1
1Q13	302,864	-1.2	0.6	4.4	-0.4	23,301	25,733	25,798	**25,877**	0.4	0.6	0.0
2Q13	353,025	-1.3	0.4	2.4	-1.5	24,409	25,973	26,029	**25,734**	0.9	0.9	-0.6
3Q13	394,731	-1.2	-0.1	3.1	-1.5	28,616	25,788	25,990	**25,361**	-0.7	-0.1	-1.4
4Q13	404,311	3.3	2.1	3.4	-0.1	27,561	26,409	26,220	**26,892**	2.4	0.9	6.0
1Q14	315,535	-1.1	-2.0	5.3	-0.1	23,044	25,737	25,667	**25,684**	-2.5	-2.1	-4.5
2Q14	372,770	-4.6	-2.3	10.7	-0.9	23,287	24,939	24,876	**24,619**	-3.1	-3.1	-4.1
3Q14	428,163	-5.1	-2.1	14.3	-1.9	27,156	24,243	24,568	**23,778**	-2.8	-1.2	-3.4
4Q14	434,567	-15.2	-3.8	26.7	-6.7	23,372	22,387	21,648	**22,784**	-7.7	-11.9	-4.2

Notes: [1] at constant prices of December 1995; SA – seasonally adjusted data; NSA --- non-seasonally adjusted data; [2] estimated by ICU.
Sources: State Statistics Service of Ukraine, Investment Capital Ukraine LLC.

Sovereign external debt: Yearly data on debt due in 2015-29

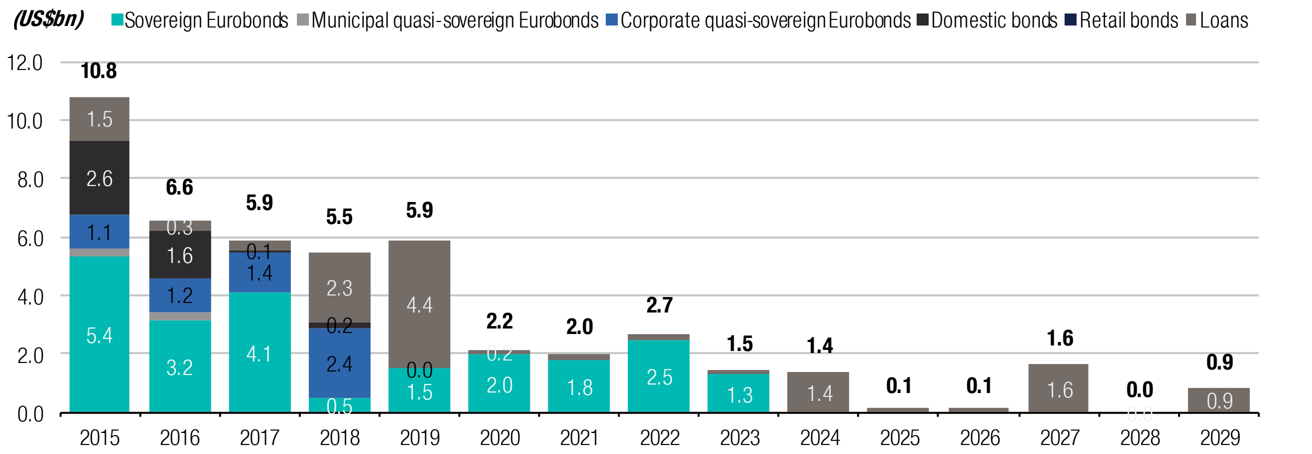
Yearly breakdown of sovereign and quasi-sovereign external debt (charts)

Chart 52. Ukraine's sovereign and quasi-sovereign external debt due in 2015-29: Breakdown by cash flow type (US$bn)



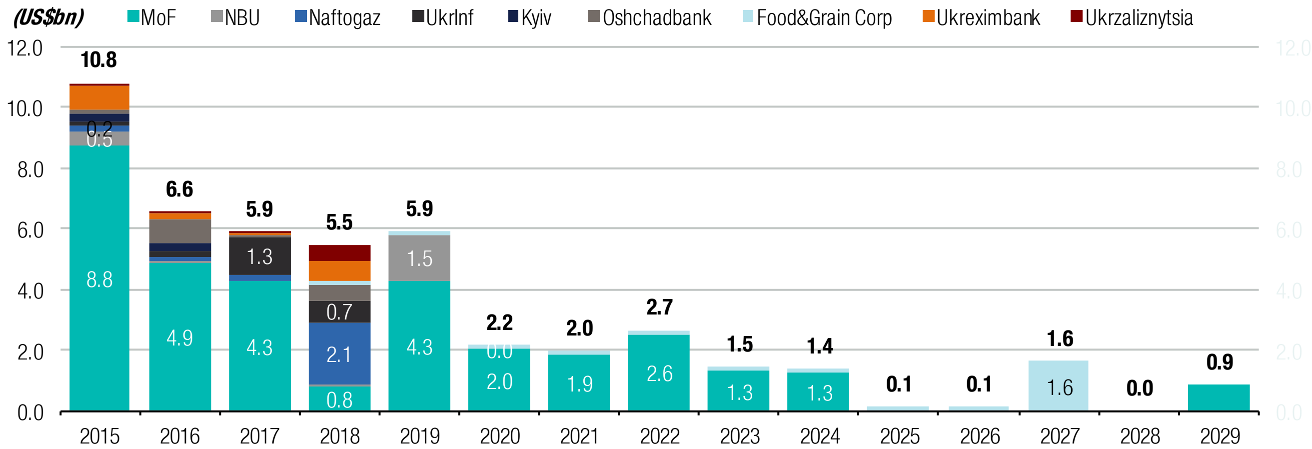
Source: Ministry of Finance of Ukraine, Bloomberg, Investment Capital Ukraine LLC.

Chart 53. Ukraine's sovereign and quasi-sovereign external debt due in 2015-29: Breakdown by ultimate borrower (US$bn)



Source: Ministry of Finance of Ukraine, Bloomberg, Investment Capital Ukraine LLC.

Chart 54. Ukraine's sovereign and quasi-sovereign external debt due in 2015-29: Breakdown by ultimate borrower (US$bn)



Source: Ministry of Finance of Ukraine, Bloomberg, Investment Capital Ukraine LLC.

Yearly breakdown of sovereign and quasi-sovereign external debt (tables)

Table 11. Breakdown of the sovereign and quasi-sovereign external debt, including interest payments and principal re-payments (US$m)
By type of debt instrument, data as of 18 February 2015

Year	Principal re-payments: Sovrgn Euro-bonds[1]	Muni-cipal Euro-bonds[2]	Corpo-rate Euro-bonds[3]	Local bonds[4]	Local retail bonds[5]	Loans[6]	Total	Interest payments: Sovrgn Euro-bonds[1]	Muni-cipal Euro-bonds[2]	Corpo-rate Euro-bonds[3]	Local bonds[4]	Local retail bonds[5]	Loans[6]	Total	Grand Total
2015	4,181	250	750	2,287	0	1,150	8,618	1,173	20	389	278	0	350	2,209	**10,828**
2016	2,250	300	825	1,461	0	0	4,836	916	0	325	144	0	341	1,725	**6,562**
2017	3,300	0	1,118	0	0	0	4,418	811	0	293	51	0	338	1,492	**5,910**
2018	0	0	2,290	200	0	2,000	4,490	523	0	98	15	0	344	979	**5,469**
2019	1,000	0	0	0	0	4,208	5,208	514	0	0	0	0	206	720	**5,928**
2020	1,500	0	0	0	0	0	1,500	505	0	0	0	0	167	672	**2,172**
2021	1,500	0	0	0	0	0	1,500	329	0	0	0	0	167	496	**1,996**
2022	2,250	0	0	0	0	0	2,250	269	0	0	0	0	167	436	**2,686**
2023	1,250	0	0	0	0	0	1,250	47	0	0	0	0	167	214	**1,464**
2024	0	0	0	0	0	1,249	1,249	0	0	0	0	0	157	157	**1,406**
2025	0	0	0	0	0	0	0	0	0	0	0	0	146	146	**146**
2026	0	0	0	0	0	0	0	0	0	0	0	0	146	146	**146**
2027	0	0	0	0	0	1,500	1,500	0	0	0	0	0	146	146	**1,646**
2028	0	0	0	0	0	0	0	0	0	0	0	0	18	18	**18**
2029	0	0	0	0	0	863	863	0	0	0	0	0	18	18	**881**
Total	**17,231**	**550**	**4,983**	**3,948**	**0**	**10,970**	**37,683**	**5,087**	**20**	**1,104**	**487**	**0**	**2,876**	**9,574**	**47,257**

Notes: [1] sovereign Eurobonds; [2] municipal Eurobonds issued by City of Kyiv, which are considered as quasi-sovereign external debt; [3] corporate Eurobonds issued by state-run banks and non-bank entities, which are considered as quasi-sovereign external debt; [4] foreign-currency sovereign bonds issued on the domestic bond market; [4] USD-denominated sovereign bonds issued domestically with special purpose to be sold to retail investors; [6] IMF loans extended to MoF and NBU.

Sources: Ministry of Finance of Ukraine, Bloomberg, Investment Capital Ukraine LLC.

Table 12. Breakdown of the sovereign and quasi-sovereign external debt, including interest payments and principal re-payments (US$m)
By ultimate borrower, data as of 18 February 2015

Year	Principal re-payments: MoF	NBU	Kyiv[1]	Nafto-gaz	Ukr-Inf[2]	Osch-ad-bank	Ukr-exim-bank	Ukr-zaliz-nytsia	Food& Grain[3]	Total	Interest payments: MoF	NBU	Kyiv[1]	Nafto-gaz	Ukr-Inf[2]	Osch-ad-bank	Ukr-exim-bank	Ukr-zaliz-nytsia	Food& Grain[3]	Total	Total
2015	7,170	449	250	0	0	0	750	0	0	8,618	1,582	49	20	170	148	102	91	48	0	2,209	**10,828**
2016	3,711	0	300	0	0	700	125	0	0	4,836	1,185	45	0	170	148	73	56	48	0	1,725	**6,562**
2017	3,300	0	0	0	1,118	0	0	0	0	4,418	985	44	0	170	148	44	53	48	0	1,492	**5,910**
2018	200	0	0	2,000	690	500	600	500	0	4,490	639	31	0	85	26	22	26	24	127	979	**5,469**
2019	3,751	1,457	0	0	0	0	0	0	0	5,208	581	12	0	0	0	0	0	0	127	720	**5,928**
2020	1,500	0	0	0	0	0	0	0	0	1,500	544	0	0	0	0	0	0	0	128	672	**2,172**
2021	1,500	0	0	0	0	0	0	0	0	1,500	369	0	0	0	0	0	0	0	127	496	**1,996**
2022	2,250	0	0	0	0	0	0	0	0	2,250	309	0	0	0	0	0	0	0	127	436	**2,686**
2023	1,250	0	0	0	0	0	0	0	0	1,250	87	0	0	0	0	0	0	0	127	214	**1,464**
2024	1,249	0	0	0	0	0	0	0	0	1,249	29	0	0	0	0	0	0	0	128	157	**1,406**
2025	0	0	0	0	0	0	0	0	0	0	18	0	0	0	0	0	0	0	127	146	**146**
2026	0	0	0	0	0	0	0	0	0	0	18	0	0	0	0	0	0	0	127	146	**146**
2027	0	0	0	0	0	0	0	0	1,500	1,500	18	0	0	0	0	0	0	0	127	146	**1,646**
2028	0	0	0	0	0	0	0	0	0	0	18	0	0	0	0	0	0	0	0	18	**18**
2029	863	0	0	0	0	0	0	0	0	863	18	0	0	0	0	0	0	0	0	18	**881**
Total	**26,744**	**1,906**	**550**	**2,000**	**1,808**	**1,200**	**1,475**	**500**	**1,500**	**37,683**	**6,399**	**181**	**20**	**595**	**470**	**242**	**226**	**166**	**1,276**	**9,574**	**47,257**

Notes: Notes: [1] City of Kyiv; [2] Financing of Infrastructural Projects (Bloomberg code: UKRINF); [3] State Food and Grain Corporation.

Sources: Ministry of Finance of Ukraine, Bloomberg, Investment Capital Ukraine LLC.

ICU consumer basket: Observation of Kiev, New-York and Moscow prices

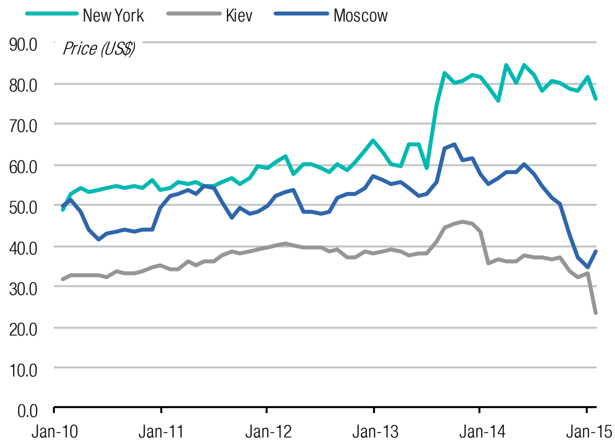
Table 13. ICU consumer basket as of end of February 2015
price observation in the urban areas of Ukraine, USA and Russia, ie, in the countries' most populated cities – Kiev, New-York, and Moscow

Item of the basket	Description	Kiev, central district 28-Feb-15 Price (UAH)	New York metro-politan area 28-Feb-15 Price (US$)	Moscow, central district 28-Feb-15 Price (RUB)
Consumer goods				
Coca-cola (0.5 litre, plastic bottle)	Non-alcohol beverages	5.58	2.50	52.90
Beer Corona Extra (0.33 litre, glass bottle)	Alcoholic beverages	16.02	1.66	83.25
Bunch of fresh bananas (1 kg)	From Ecuador	36.59	1.74	99.90
Pack of milk (1 litter)	Locally produced, soft package, i.e., not glass bottle	11.10	2.03	66.90
Chicken meat (1 kg pack)	Locally produced and branded package, boneless breast	59.59	12.08	169.00
Canned pineapple (0.85 kg, can)	Pineapple circles, Dole brand	41.40	2.70	170.00
Pasta (0.5 kg)	Soft package, produced in Italy	32.29	1.59	108.00
Sugar (1 kg)		13.10	3.63	59.90
Package of table salt (0.5 kg)		13.50	0.53	16.70
Chicken eggs (10 units pack)	White eggs, standard size	22.52	3.20	91.90
Chocolate (100 g)	Made by Craft Foods Corp, Milka brand	22.55	1.90	87.90
Toothpaste (100ml package)	Colgate	49.55	4.33	170.00
Shampoo (200ml package)	Head & Shoulders brand, for normal hair	52.74	3.11	170.00
Toilet paper (4 rolls package)	Kleenex Cottonelle brand, white paper, Regular toilet tissue	58.68	2.68	98.90
Magazine	Men's Health, local edition, A4 format (standard one, not a pocket book format)	33.88	5.99	130.00
Gasoline (1 litre)	Lukoil, regular	27.85	0.67	35.95
Batteries (AA x 4 pack)	A 4-pack of AA Duracell batteries, Alkaline	37.05	3.99	140.00
Coffee (250 g, vacuum pack)	Jacobs Monarch, brick-like vacuum pack	49.85	4.50	190.00
Services				
Underground commute ticket	Within the central part of the city	4.00	2.50	40.00
Cinema ticket	Thursday's night price for the seat with good location, Hollywood film	45.00	14.99	400.00
Total basket value (in local currency)		**632.84**	**76.32**	**2,381.20**
Exchange rate versus US dollar at spot market as of date of observation		27.250	1.000	61.754
Total basket value (in US$)		**23.22**	**76.32**	**38.56**
Overvalued "+" / undervalued "-" (%)				
UAH vs. USD		**-69.57**		
UAH vs. RUR		**-39.77**		
Fair value in the long-run as of observation date				
UAH per USD		**8.292**		
UAH per RUR		**0.266**		

Source: Investment Capital Ukraine.

Chart 55. ICU consumer basket value (US$)

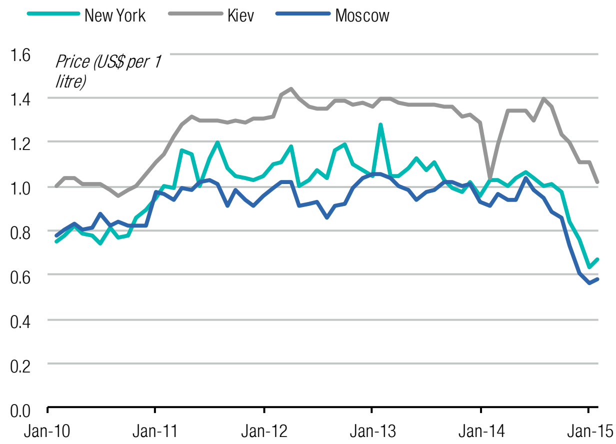
Price history from February 2010 till February 2015



Source: Investment Capital Ukraine.

Chart 56. Gasoline A95 equivalent 1 litre (US$)

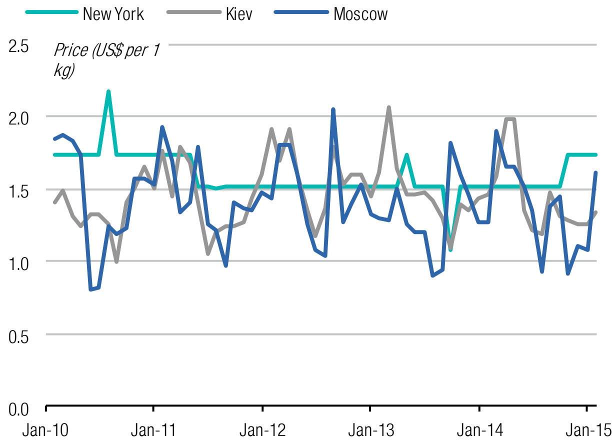
Price history from February 2010 till February 2015



Source: State Statistics Service of Ukraine.

Chart 57. Fresh banana 1 kg bunch (US$)

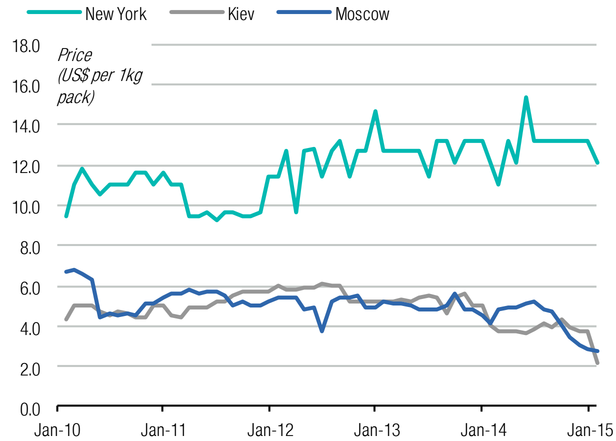
Price history from February 2010 till February 2015



Source: Investment Capital Ukraine.

Chart 58. Chicken meat 1 kg pack of boneless breast (US$)

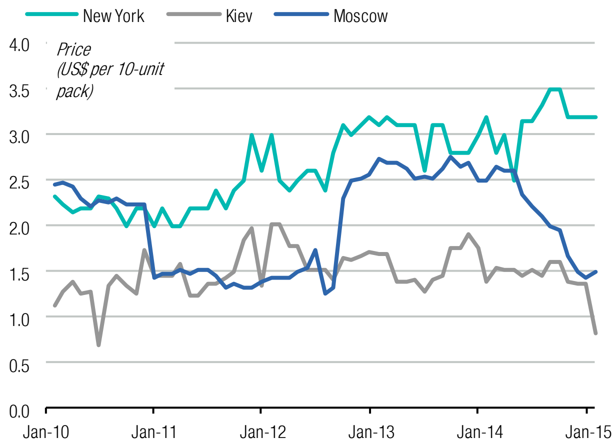
Price history from February 2010 till February 2015



Source: State Statistics Service of Ukraine.

Chart 59. Chicken eggs 10-unit pack (US$)

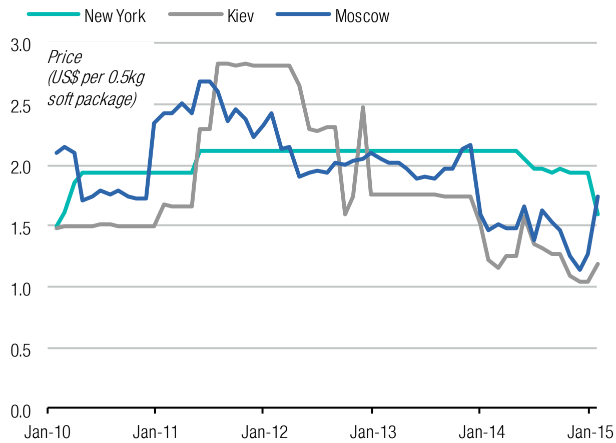
Price history from February 2010 till February 2015



Source: Investment Capital Ukraine.

Chart 60. Pasta 0.5 kg soft package Italy-made (US$)

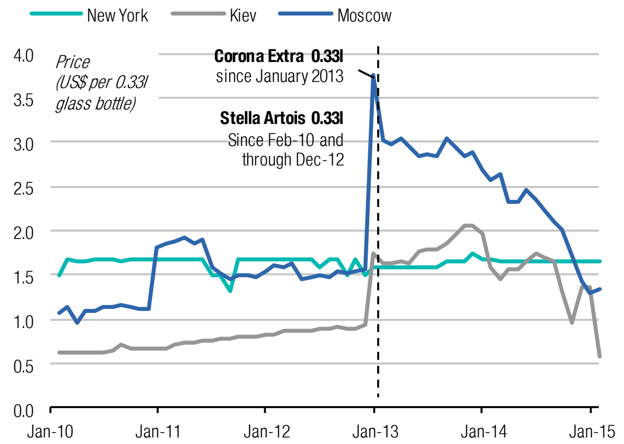
Price history from February 2010 till February 2015



Source: Investment Capital Ukraine.

Chart 61. Beer Corona Extra 0.33 litre glass bottle (US$)

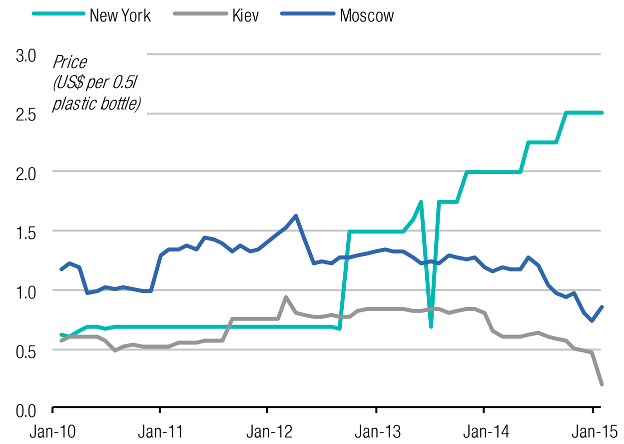
Price history from February 2010 till February 2015



Source: State Statistics Service of Ukraine.

Chart 62. Coca-Cola 0.5 litre plastic bottle (US$)

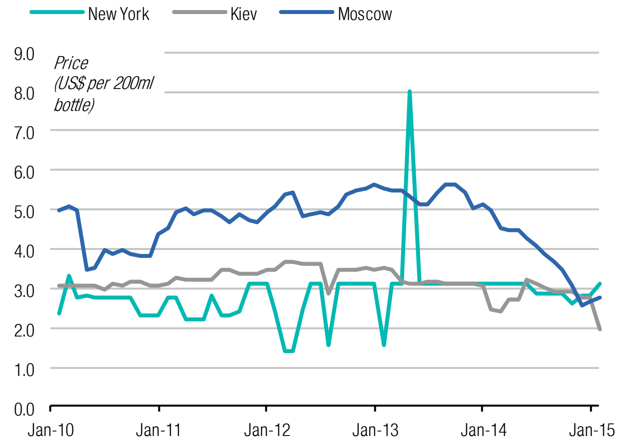
Price history from February 2010 till February 2015



Source: State Statistics Service of Ukraine.

Chart 63. Shampoo 200ml bottle Head & Shoulders (US$)

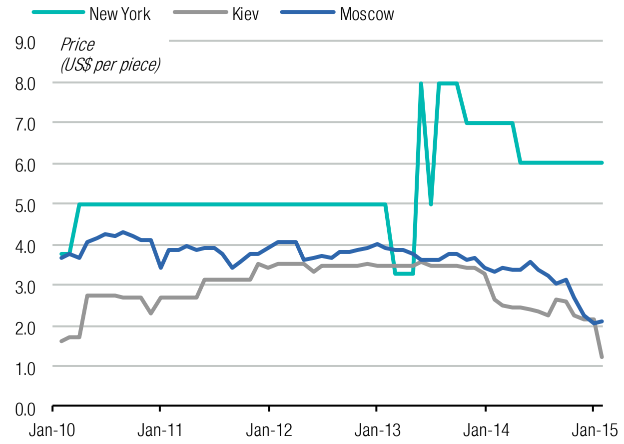
Price history from February 2010 till February 2015



Source: State Statistics Service of Ukraine.

Chart 64. Magazine *Men's Health,* A4 format (US$)

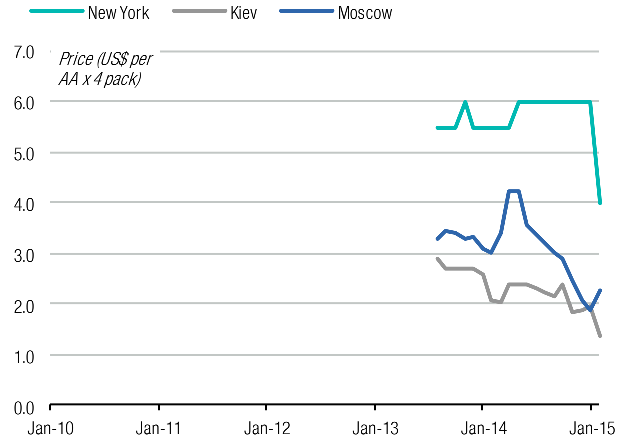
Price history from February 2010 till February 2015



Source: State Statistics Service of Ukraine.

Chart 65. Duracell batteries (AA x 4 pack) (US$)

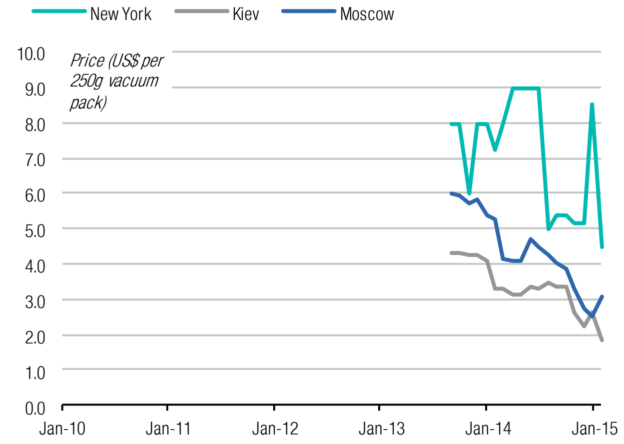
Price history from August 2013 till February 2015



Source: State Statistics Service of Ukraine.

Chart 66. Jacobs Monarch coffee, 250 g vacuum pack (US$)

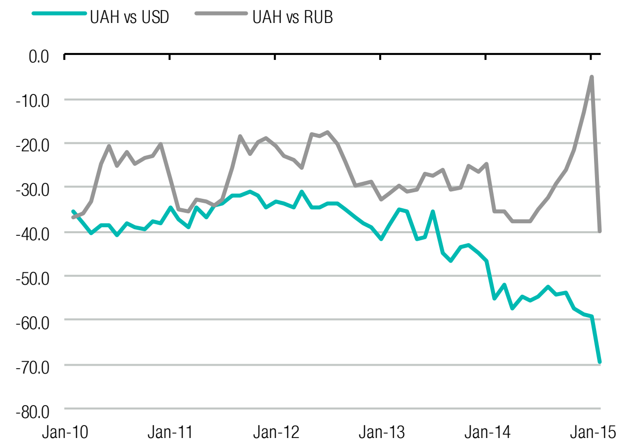
Price history from September 2010 till February 2015



Source: State Statistics Service of Ukraine.

Chart 67. Value gap of ICU basket in UAH vs. USD and RUB (%)

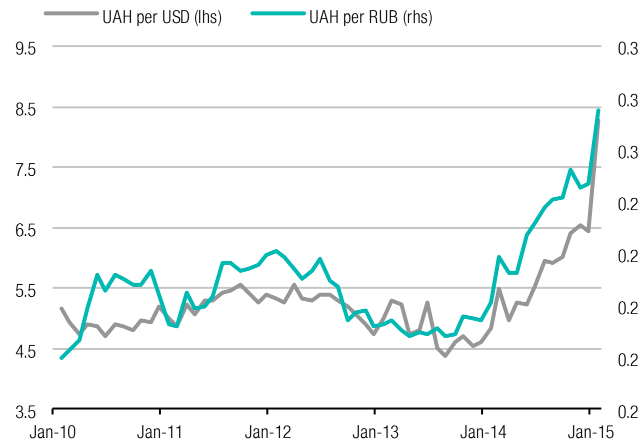
Price history from February 2010 till February 2015



Source: State Statistics Service of Ukraine.

Chart 68. An exchange rate level of UAH per USD and UAH per RUB, which would eliminate the value gap of ICU basket

Price history from February 2010 till February 2015



Source: State Statistics Service of Ukraine.

Balance of payments forecast 2015-18: Tables with scenarios

Table 14. Balance of payments projections for the period 2015-18 (US$m)

Under assumption that only sovereign Eurobonds due in the forecast period are due to restructuring.
Rollover ratios for banks and corporations is at the average levels seen in the last 12-month period, which is from February 2014 through January 2015.
IMF and donors financing according to the plan see Table 7 on p.42.

	Forecast period				Rollover ratios				
	2015	2016	2017	2018	2015	2016	2017	2018	Comment
Current account balance	**-2,330**	**-978**	**-2,540**	**-2,371**					
Short-term debt due	**-46,705**	**-33,792**	**-29,835**	**-30,052**					
Government									
Official lenders	-701	0	0	0	1123%	0%	0%	0%	Official lending by IMF, donors
Russian banks	0	0	0	0	0%	0%	0%	0%	
Eurobonds	0	0	0	0	...	...	...	...	... means to be restructured
Domestic FX bonds	-2,287	-1,461	0	-200	100%	100%	100%	0%	To be rolled over w local banks
Other	0	0	0	0	0%	0%	0%	0%	
Central bank									
Official lenders (IMF)	-449	0	0	0	1783%	...	...	0%	Borrowings from IMF
Other	0	0	0	0	0%	0%	0%	0%	
Banks									
Eurobonds	-969	-986	-61	-1,385	0%	0%	0%	0%	No access to the market
Other lenders	-9,878	-8,781	-8,781	-8,781	89%*	100%	100%	100%	Rollover ratios recovers to 100%
Corporations									
Eurobonds	-1,785	-750	-1,318	-1,940	0%	0%	0%	0%	No access to the market
Loans	-6,969	-4,962	-4,476	-4,037	79%*	100%	100%	100%	Rollover ratios recovers to 100%
Trade loans	-16,168	-11,512	-10,384	-9,366	79%*	100%	100%	100%	Rollover ratios recovers to 100%
Other	-7,499	-5,340	-4,816	-4,344	79%*	100%	100%	100%	Rollover ratios recovers to 100%
Dom demand for FX	-4,000	-4,000	-4,000	-4,000					Assumed to be $4bn/yr
Total financing needs	**-53,035**	**-38,770**	**-36,375**	**-36,423**					
FDI, inflows	333	1,185	1,209	1,288					According to ICU BoP proj'ns
Borrowings									
Government	12,167	1,461	0	0					
Central bank	8,000	8,640	5,000	0					
Banks	8,781	8,781	8,781	8,781					
Corporations	24,185	21,814	19,676	17,747					
Total financing	**53,466**	**41,880**	**34,666**	**27,816**					
Use of reserves	**+431**	**+3,111**	**-1,710**	**-8,607**					
FX reserves									
At the start of year	7,533	7,964	11,075	9,365					
At the end of year	7,964	11,075	9,365	758					
Change (%YoY)	5.7	39.1	-15.4	-91.9					
FX reserves (% of GDP)									
At the start of year	5.8	10.6	13.0	10.2					
At the end of year	10.6	13.0	10.2	0.6					
Change (ppt)	4.8	2.5	-2.9	-9.6					
FX res imp cov (months)									
At the start of year	1.2	1.6	2.2	1.8					
At the end of year	1.6	2.2	1.8	0.1					
Change (months)	0.3	0.6	-0.4	-1.6					

Note: * rollover ratios assumed for 2015 are at the avearge level seen in the last 12 month period from February 2014 through January 2015, see the right-hand part of the Chart 44 on p.40. Source: ICU.

Table 15. Balance of payments projections for the period 2015-18 (US$m)

Under assumption that sovereign Eurobonds due in the forecast period are due to restructuring as well as the quasi-sovereign and private sector banks and corporations follow suit.

Rollover ratios for banks and corporations is at the average levels seen in the last 12-month period, which is from February 2014 through January 2015. IMF and donors financing according to the plan see Table 7 on p.42.

	Forecast period				Rollover ratios				
	2015	2016	2017	2018	2015	2016	2017	2018	Comment
Current account balance	**-2,330**	**-978**	**-2,540**	**-2,371**					
Short-term debt due	**-43,952**	**-32,056**	**-28,456**	**-26,727**					
Government									
Official lenders	-701	0	0	0	1123%	0%	0%	0%	Official lending by IMF, donors
Russian banks	0	0	0	0	0%	0%	0%	0%	
Eurobonds	0	0	0	0	...	...	...	...	To be restructured
Domestic FX bonds	-2,287	-1,461	0	-200	100%	100%	100%	0%	To be rolled over w local banks
Other	0	0	0	0	0%	0%	0%	0%	
Central bank									
Official lenders (IMF)	-449	0	0	0	1783%	...	...	0%	Borrowings from IMF
Other	0	0	0	0	0%	0%	0%	0%	
Banks									
Eurobonds	0	0	0	0	0%	0%	0%	0%	No access to the market
Other lenders	-9,878	-8,781	-8,781	-8,781	89%*	100%	100%	100%	Rollover ratios recovers to 100%
Corporations									
Eurobonds	0	0	0	0	0%	0%	0%	0%	No access to the market
Loans	-6,969	-4,962	-4,476	-4,037	79%*	100%	100%	100%	Rollover ratios recovers to 100%
Trade loans	-16,168	-11,512	-10,384	-9,366	79%*	100%	100%	100%	Rollover ratios recovers to 100%
Other	-7,499	-5,340	-4,816	-4,344	79%*	100%	100%	100%	Rollover ratios recovers to 100%
Dom demand for FX	-4,000	-4,000	-4,000	-4,000					Assumed to be $4bn/yr
Total financing needs	**-50,281**	**-37,034**	**-34,996**	**-33,098**					
FDI, inflows	333	1,185	1,209	1,288					According to ICU BoP proj'ns
Borrowings									
Government	12,167	1,461	0	0					
Central bank	8,000	8,640	5,000	0					
Banks	8,781	8,781	8,781	8,781					
Corporations	24,185	21,814	19,676	17,747					
Total financing	**53,466**	**41,880**	**34,666**	**27,816**					
Use of reserves	**+3,184**	**+4,847**	**-330**	**-5,282**					
FX reserves									
At the start of year	7,533	10,717	15,564	15,234					
At the end of year	10,717	15,564	15,234	9,951					
Change (%YoY)	42.3	45.2	-2.1	-34.7					
FX reserves (% of GDP)									
At the start of year	5.8	14.2	18.3	16.5					
At the end of year	14.2	18.3	16.5	7.6					
Change (ppt)	8.4	4.1	-1.8	-8.9					
FX res imp cov (months)									
At the start of year	1.2	2.1	3.1	2.8					
At the end of year	2.1	3.1	2.8	1.8					
Change (months)	0.9	1.0	-0.2	-1.1					

Note: * rollover ratios assumed for 2015 are at the avearge level seen in the last 12 month period from February 2014 through January 2015, see the right-hand part of the Chart 44 on p.40. Source: ICU.

Table 16. Balance of payments projections for the period 2015-18 (US$m)

Under assumption that sovereign Eurobonds due in the forecast period are due to restructuring as well as the quasi-sovereign and private sector banks and corporations follow suit.

Rollover ratios for banks and corporations are at 50% for 2015 and then recover to 75% in 2016 and to 100% in 2017-18.

IMF and donors financing according to the plan see Table 7 on p.42.

	Forecast period				Rollover ratios				
	2015	2016	2017	2018	2015	2016	2017	2018	Comment
Current account balance	**-2,330**	**-978**	**-2,540**	**-2,371**					
Short-term debt due	**-43,952**	**-20,217**	**-13,051**	**-12,335**					
Government									
Official lenders	-701	0	0	0	1123%	0%	0%	0%	Official lending by IMF, donors
Russian banks	0	0	0	0	0%	0%	0%	0%	
Eurobonds	0	0	0	0	0%	0%	0%	0%	To be restructured
Domestic FX bonds	-2,287	-1,461	0	-200	100%	100%	100%	0%	To be rolled over w local banks
Other	0	0	0	0	0%	0%	0%	0%	
Central bank									
Official lenders (IMF)	-449	0	0	0	...	...	...	0%	Borrowings from IMF
Other	0	0	0	0	0%	0%	0%	0%	
Banks									
Eurobonds	0	0	0	0	0%	0%	0%	0%	No access to the market
Other lenders	-9,878	-4,939	-3,704	-3,704	50%	75%	100%	100%	Rollover ratios recovers to 100%
Corporations									
Eurobonds	0	0	0	0	0%	0%	0%	0%	No access to the market
Loans	-6,969	-3,143	-2,126	-1,918	50%	75%	100%	100%	Rollover ratios recover 10%/yr
Trade loans	-16,168	-7,292	-4,933	-4,449	50%	75%	100%	100%	Rollover ratios recover 10%/yr
Other	-7,499	-3,382	-2,288	-2,064	50%	75%	100%	100%	Rollover ratios recover 10%/yr
Dom demand for FX	-4,000	-4,000	-4,000	-4,000					Assumed to be $4bn/yr
Total financing needs	**-50,281**	**-25,195**	**-19,591**	**-18,705**					
FDI, inflows	333	1,185	1,209	1,288					According to ICU BoP proj'ns
Borrowings									
Government	12,167	1,461	0	0					
Central bank	8,000	8,640	5,000	0					
Banks	4,939	3,704	3,704	3,704					
Corporations	15,318	10,363	9,347	8,431					
Total financing	**40,758**	**25,353**	**19,260**	**13,423**					
Use of reserves	**-9,524**	**+158**	**-330**	**-5,282**					
FX reserves									
At the start of year	7,533	-1,991	-1,833	-2,163					
At the end of year	-1,991	-1,833	-2,163	-7,445					
Change (%YoY)	-126.4	-7.9	18.0	244.2					
FX reserves (% of GDP)									
At the start of year	5.8	-2.6	-2.2	-2.3					
At the end of year	-2.6	-2.2	-2.3	-5.7					
Change (ppt)	-8.4	0.5	-0.2	-3.4					
FX res imp cov (months)									
At the start of year	1.2	-0.4	-0.4	-0.4					
At the end of year	-0.4	-0.4	-0.4	-1.3					
Change (months)	-1.6	0.0	0.0	-0.9					

Source: ICU.

Table 17. Balance of payments projections for the period 2015-18 (US$m)

Under assumption that sovereign Eurobonds due in the forecast period are due to restructuring as well as the quasi-sovereign and private sector banks and corporations follow suit.

Rollover ratios for banks and corporations recover to 81% and 65% in 2015, then 95% and 85% in 2016 in 2016 and 100% in 2017-18.

IMF and donors financing according to the plan see Table 7 on p.42.

	Forecast period				Rollover ratios				
	2015	2016	2017	2018	2015	2016	2017	2018	Comment
Current account balance	**-2,330**	**-978**	**-2,540**	**-2,371**					
Short-term debt due	**-43,952**	**-27,424**	**-21,372**	**-20,222**					
Government									
Official lenders	-701	0	0	0	1123%	0%	0%	0%	Official lending by IMF, donors
Russian banks	0	0	0	0	0%	0%	0%	0%	
Eurobonds	0	0	0	0	0%	0%	0%	0%	To be restructured
Domestic FX bonds	-2,287	-1,461	0	-200	100%	100%	100%	0%	To be rolled over w local banks
Other	0	0	0	0	0%	0%	0%	0%	
Central bank									
Official lenders (IMF)	-449	0	0	0	...	...	...	0%	Borrowings from IMF
Other	0	0	0	0	0%	0%	0%	0%	
Banks									
Eurobonds	0	0	0	0	0%	0%	0%	0%	No access to the market
Other lenders	-9,878	-8,001	-7,601	-7,601	81%	95%	100%	100%	Rollover ratios recovers to 100%
Corporations									
Eurobonds	0	0	0	0	0%	0%	0%	0%	No access to the market
Loans	-6,969	-4,086	-3,132	-2,825	65%	85%	100%	100%	Rollover ratios recover 10%/yr
Trade loans	-16,168	-9,479	-7,267	-6,555	65%	85%	100%	100%	Rollover ratios recover 10%/yr
Other	-7,499	-4,397	-3,371	-3,041	65%	85%	100%	100%	Rollover ratios recover 10%/yr
Dom demand for FX	-4,000	-4,000	-4,000	-4,000					Assumed to be $4bn/yr
Total financing needs	**-50,281**	**-32,402**	**-27,912**	**-26,593**					
FDI, inflows	333	1,185	1,209	1,288					According to ICU BoP proj'ns
Borrowings									
Government	12,167	1,461	0	0					
Central bank	8,000	8,640	5,000	0					
Banks	8,001	7,601	7,601	7,601					
Corporations	19,914	15,267	13,771	12,421					
Total financing	**48,415**	**34,155**	**27,581**	**21,310**					
Use of reserves	**-1,866**	**+1,753**	**-330**	**-5,282**					
FX reserves									
At the start of year	7,533	5,667	7,420	7,089					
At the end of year	5,667	7,420	7,089	1,807					
Change (%YoY)	-24.8	30.9	-4.5	-74.5					
FX reserves (% of GDP)									
At the start of year	5.8	7.5	8.7	7.7					
At the end of year	7.5	8.7	7.7	1.4					
Change (ppt)	1.7	1.2	-1.0	-6.3					
FX res imp cov (months)									
At the start of year	1.2	1.1	1.5	1.3					
At the end of year	1.1	1.5	1.3	0.3					
Change (months)	-0.1	0.4	-0.1	-1.0					

Source: ICU.

Table 18. Balance of payments projections for the period 2015-18 (US$m)

Under assumption that only sovereign Eurobonds due in the forecast period are due to restructured, exclduing the US$3bn Dec-15 Russian Eurobond. Rollover ratios for banks and corporations is at the average levels seen in the last 12-month period, which is from February 2014 through January 2015. IMF and donors financing according to the plan see Table 7 on p.42.

	Forecast period				Rollover ratios				
	2015	**2016**	**2017**	**2018**	**2015**	**2016**	**2017**	**2018**	**Comment**
Current account balance	**-2,330**	**-978**	**-2,540**	**-2,371**					
Short-term debt due	**-46,952**	**-32,056**	**-28,456**	**-26,727**					
Government									
Official lenders	-701	0	0	0	1123%	0%	0%	0%	Official lending by IMF, donors
Russian banks	0	0	0	0	0%	0%	0%	0%	
Eurobonds	-3,000	0	0	0	67%	0%	0%	0%	To be restructured, ex Russia
Domestic FX bonds	-2,287	-1,461	0	-200	100%	100%	100%	0%	To be rolled over w local banks
Other	0	0	0	0	0%	0%	0%	0%	
Central bank									
Official lenders (IMF)	-449	0	0	0	...	...	...	0%	Borrowings from IMF
Other	0	0	0	0	0%	0%	0%	0%	
Banks									
Eurobonds	0	0	0	0	0%	0%	0%	0%	No access to the market
Other lenders	-9,878	-8,781	-8,781	-8,781	92%	100%	100%	100%	Rollover ratios recovers to 100%
Corporations									
Eurobonds	0	0	0	0	0%	0%	0%	0%	No access to the market
Loans	-6,969	-4,962	-4,476	-4,037	84%	100%	100%	100%	Rollover ratios recovers to 100%
Trade loans	-16,168	-11,512	-10,384	-9,366	84%	100%	100%	100%	Rollover ratios recovers to 100%
Other	-7,499	-5,340	-4,816	-4,344	84%	100%	100%	100%	Rollover ratios recovers to 100%
Dom demand for FX	-4,000	-4,000	-4,000	-4,000					Assumed to be $4bn/yr
Total financing needs	**-53,281**	**-37,034**	**-34,996**	**-33,098**					
FDI, inflows	333	1,185	1,209	1,288					According to ICU BoP proj'ns
Borrowings									
Government	12,167	1,461	0	0					
Central bank	8,000	8,640	5,000	0					
Banks	8,781	8,781	8,781	8,781					
Corporations	24,185	21,814	19,676	17,747					
Total financing	**53,466**	**41,880**	**34,666**	**27,816**					
Use of reserves	**+184**	**+4,847**	**-330**	**-5,282**					
FX reserves									
At the start of year	7,533	7,717	12,564	12,234					
At the end of year	7,717	12,564	12,234	6,951					
Change (%YoY)	2.4	62.8	-2.6	-43.2					
FX reserves (% of GDP)									
At the start of year	5.8	10.3	14.8	13.3					
At the end of year	10.3	14.8	13.3	5.3					
Change (ppt)	4.5	4.5	-1.5	-8.0					
FX res imp cov (months)									
At the start of year	1.2	1.5	2.5	2.3					
At the end of year	1.5	2.5	2.3	1.2					
Change (months)	0.3	1.0	-0.2	-1.0					

Source: ICU.

Impact of external debt restructuring (scenario #1)

Macro: Average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH average FX rate in 2015, 2016 and 2017 is 25.25, 27 and 29.75.5 respectively. See Table 8 on p.45.

External debt restructuring: sovereign Eurobonds are restructured with total face value of US$16.2bn (this excludes the Eurobond backed by US government and includes the US$3bn Eurobond). New Eurobond details: fixed **coupon rate 4.5%**; redemption starts in 2021 by 15 equal installments each US$1.08bn a year. **No principal haircut**.

Table 19. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Activity															
Real GDP % YoY	9.6	12.1	2.7	7.3	7.9	2.3	-14.8	4.1	5.2	0.2	-0.1	-6.7	**-7.6**	**0.0**	**2.6**
Nominal GDP (UAHbn)	267.3	345.1	441.5	544.2	720.7	948.1	913.3	1,082.6	1,302.1	1,408.9	1,454.9	1,551.0	**1,903.4**	**2,298.5**	**2,744.8**
Nominal GDP (US$bn)	50.1	64.9	86.9	108.2	143.3	183.9	113.7	136.3	163.0	174.2	178.3	130.1	**75.3**	**84.9**	**92.1**
Nominal GDP @2002 prices	245.7	271.2	277.0	294.4	313.1	318.7	276.2	286.1	299.1	299.6	299.3	281.7	**265.3**	**265.3**	**271.1**
Inflation															
CPI headline (%YoY, eop)	8.2	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	**25.1**	**16.4**	**14.5**
CPI headline (%YoY, average)	5.2	9.0	13.6	9.1	12.8	25.3	16.0	9.4	8.0	0.6	-0.3	12.1	**29.0**	**17.9**	**15.0**
Index GDP defl avg @2002 prices	108.8	127.3	159.4	184.8	230.2	297.5	330.6	378.3	435.4	470.2	486.1	550.6	**717.5**	**866.5**	**1,012.5**
FX rate															
US$ in UAH (eop)	5.33	5.31	5.05	5.05	5.05	7.80	8.00	7.94	8.00	8.05	8.24	15.82	**26.00**	**28.00**	**30.00**
US$ in UAH (average)	5.33	5.32	5.10	5.03	5.03	5.25	8.03	7.94	7.99	8.08	8.16	12.00	**25.25**	**27.00**	**29.75**
Budget (UAHbn)															
Revenues	55.0	70.3	105.3	133.5	165.9	231.7	209.7	240.6	314.6	346.0	339.2	357.0	**420.6**	**507.5**	**605.9**
Expenditures	56.0	79.5	113.0	137.1	174.3	241.5	242.4	303.6	333.4	395.7	403.4	430.1	**563.2**	**591.2**	**691.6**
Balance	-1.0	-9.1	-7.6	-3.6	-8.3	-9.8	-32.7	-63.0	-18.8	-49.6	-64.2	-73.2	**-142.6**	**-83.7**	**-85.7**
Debt service	0.0	3.1	3.1	3.1	3.3	3.8	9.0	15.5	23.1	23.9	31.8	47.1	**68.5**	**86.1**	**92.0**
in local ccy	0.0	1.0	1.0	0.9	0.7	0.9	4.7	10.9	15.5	17.0	21.9	32.5	**34.9**	**45.1**	**52.7**
in foreign ccy	0.0	2.1	2.1	2.2	2.6	2.9	4.4	4.7	7.6	5.6	8.6	12.5	**33.7**	**41.1**	**39.3**
Primary expenditures	56.0	76.4	109.9	134.0	170.9	237.7	233.4	288.0	310.3	371.8	371.6	383.0	**494.7**	**505.0**	**599.6**
Primary expenditures @2002 prices	51.5	60.0	68.9	72.5	74.2	79.9	70.6	76.1	71.3	79.1	76.4	69.6	**68.9**	**58.3**	**59.2**
Primary balance	-1.0	-6.0	-4.5	-0.5	-5.0	-6.0	-23.7	-47.4	4.3	-25.8	-32.4	-26.1	**-74.1**	**2.4**	**6.3**
Naftogaz, Banks, SDGF fin req.	…	…	…	…	…	…	…	…	…	…	…	…	**150.0**	**50.0**	**50.0**
Net borrowing (historical data)															
Domestic borrowing (UAHbn)		4.1	7.2	1.6	3.6	25.3	62.3	70.7	53.6	67.6	109.8	227.3	…	…	…
External borrowing (US$bn)		1.1	0.7	1.9	1.2	0.0	4.7	6.6	2.8	4.9	6.0	7.2	…	…	…
Domestic redemptions (UAHbn)		1.3	2.5	4.7	3.5	5.9	13.5	30.9	47.4	53.5	66.8	98.9	**144.1**	**133.2**	**83.5**
External redemptions (US$bn)		0.1	0.2	0.2	0.3	0.4	1.6	0.9	2.0	4.1	5.5	4.9	**6.2**	**3.3**	**4.2**
Net dom borrowings (UAHbn)		2.9	4.7	-3.1	0.1	19.4	48.8	39.8	6.2	14.2	43.0	128.4	…	…	…
Net ext borrowings (US$bn)		1.0	0.6	1.7	0.9	-0.4	3.1	5.7	0.7	0.8	0.5	2.3	…	…	…
Budget (% of GDP)															
Revenues	20.6	20.4	23.9	24.5	23.0	24.4	23.0	22.2	24.2	24.6	23.3	23.0	**22.1**	**22.1**	**22.1**
Expenditures	20.9	23.0	25.6	25.2	24.2	25.5	26.5	28.0	25.6	28.1	27.7	27.7	**29.6**	**25.7**	**25.2**
Balance	-0.4	-2.6	-1.7	-0.7	-1.2	-1.0	-3.6	-5.8	-1.4	-3.5	-4.4	-4.7	**-7.5**	**-3.6**	**-3.1**
Debt service %GDP	0.0	0.9	0.7	0.6	0.5	0.4	1.0	1.4	1.8	1.7	2.2	3.0	**3.6**	**3.7**	**3.4**
Primary balance	-0.4	-1.7	-1.0	-0.1	-0.7	-0.6	-2.6	-4.4	0.3	-1.8	-2.2	-1.7	**-3.9**	**0.1**	**0.2**
Primary exp @2002 prices %GDP	20.9	22.1	24.9	24.6	23.7	25.1	25.6	26.6	23.8	26.4	25.5	24.7	**26.0**	**22.0**	**21.8**
Debt service / revenues %	0.0	4.4	3.0	2.3	2.0	1.6	4.3	6.5	7.4	6.9	9.4	13.2	**16.3**	**17.0**	**15.2**
Public debt															
Direct dom debt (UAHbn)	20.5	20.6	19.2	16.6	17.8	44.7	91.1	141.7	158.3	190.3	257.0	461.0	**753.6**	**887.3**	**1,023.0**
Direct ext debt (US$bn)	8.6	8.8	8.7	9.8	10.6	11.0	15.1	22.9	24.5	26.0	27.1	30.7	**39.9**	**30.7**	**30.7**

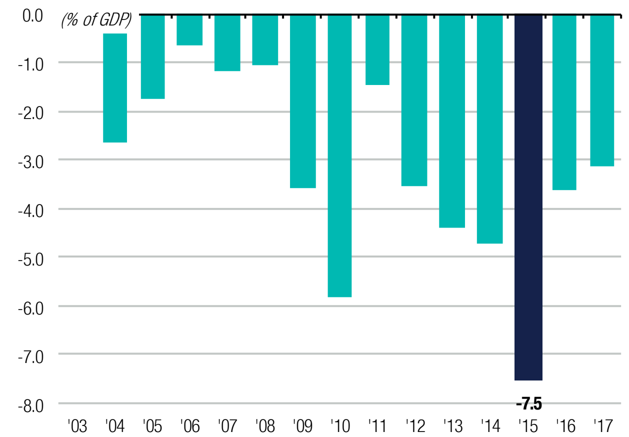
Table 19. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Guaranteed dom debt (UAHbn)	0.0	0.0	0.0	0.0	1.0	2.0	14.1	13.8	12.2	16.2	27.1	27.9	**29.9**	**31.9**	**33.9**
Guaranteed ext debt (US$bn)	2.1	3.3	3.0	2.9	3.3	7.3	9.5	12.0	13.0	12.4	9.3	8.0	**15.5**	**23.1**	**30.6**
Total (UAHbn)	77.5	85.0	78.1	80.5	88.7	189.4	301.5	432.2	469.9	515.5	584.1	1,100.6	**2,223.8**	**2,424.7**	**2,896.5**
Total debt (% of GDP)	29.0	24.6	17.7	14.8	12.3	20.0	33.0	39.9	36.1	36.6	40.1	71.0	**116.8**	**105.5**	**105.5**
Total direct (% of GDP)	24.7	19.5	14.3	12.1	9.9	13.8	23.2	29.9	27.2	28.3	33.0	61.0	**94.1**	**76.0**	**70.8**
Change															
Direct dom debt (UAHbn)		0.1	-1.4	-2.6	1.2	26.9	46.4	50.6	16.6	32.0	66.7	204.0	**292.6**	**133.7**	**135.7**
Direct ext debt (US$bn)		0.2	-0.1	1.1	0.8	0.4	4.0	7.8	1.6	1.5	1.1	3.6	**9.2**	**-9.2**	**0.0**
Guaranteed dom debt (UAHbn)		0.0	0.0	0.0	1.0	1.0	12.1	-0.2	-1.6	4.0	10.9	0.7	**2.0**	**2.0**	**2.0**
Guaranteed ext debt (US$bn)		1.2	-0.4	-0.1	0.4	4.0	2.2	2.5	1.0	-0.5	-3.1	-1.4	**7.6**	**7.6**	**7.6**
Total (UAHbn)		7.5	-6.9	2.4	8.2	100.7	112.1	130.7	37.7	45.6	68.6	516.4	**1,123.2**	**200.9**	**471.8**
Effective cost of public debt (%)															
Domestic		4.8	4.9	5.0	4.3	2.7	6.9	9.4	10.3	9.8	9.8	9.0	**9.0**	**9.0**	**9.0**
External		4.6	4.7	4.7	5.1	5.2	5.1	3.1	4.0	2.7	4.0	4.3	**4.3**	**4.3**	**4.3**
External balance															
FX res (US$bn)	6.9	9.5	19.4	22.3	32.5	31.5	26.5	34.6	31.8	24.5	20.4	7.5	**10.7**	**15.6**	**15.2**
Imports, goods+services (US$bn)	27.7	36.3	43.7	53.3	72.2	100.0	56.2	73.2	99.0	104.4	100.8	74.1	**61.0**	**60.4**	**64.2**
Imports cov (months)	2.3	2.6	4.4	3.7	3.9	6.7	4.3	4.2	3.7	2.9	3.3	1.5	**2.1**	**2.9**	**2.7**
Imports cov by FX res (weeks)	9.9	11.3	18.9	16.0	16.9	29.2	18.8	18.2	15.8	12.7	14.3	6.4	**9.2**	**12.6**	**11.8**

Sources: State Statistics Committee of Ukraine, Ministry of Finance of Ukraine, National Bank of Ukraine, ICU.

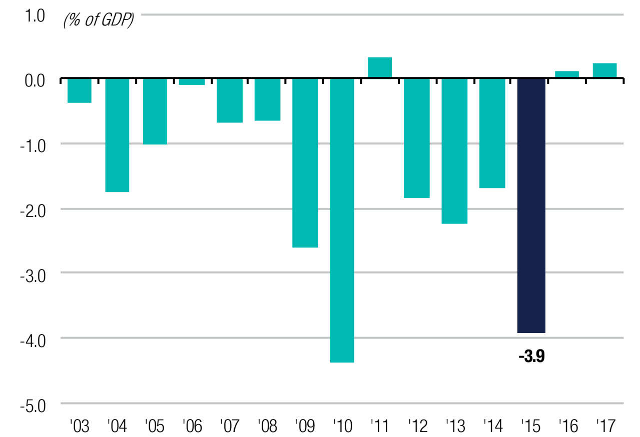
Chart 69. Budget balance of the central government(% GDP): total balance (left) and primary balance (right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

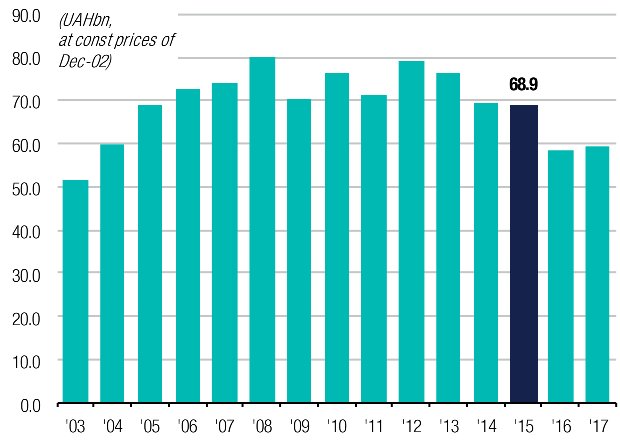
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

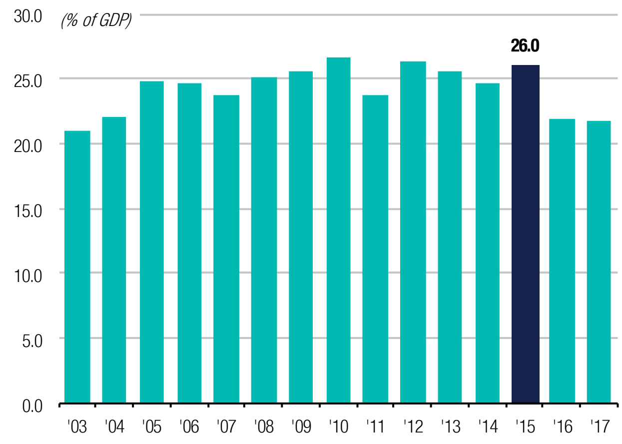
Chart 70. Budget expenditures of the central government: at constant prices of Dec-02 (UAHbn, left) and as share of GDP (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

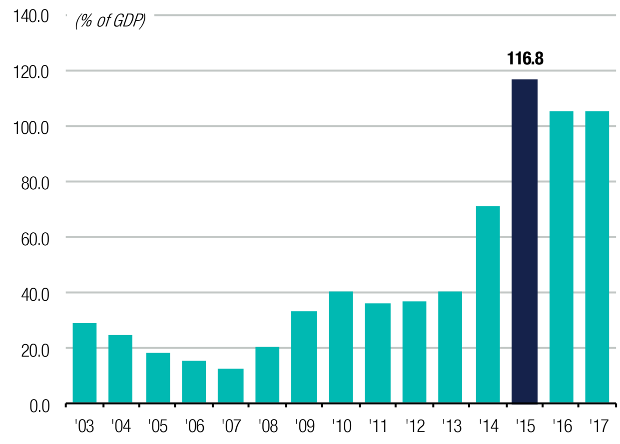
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

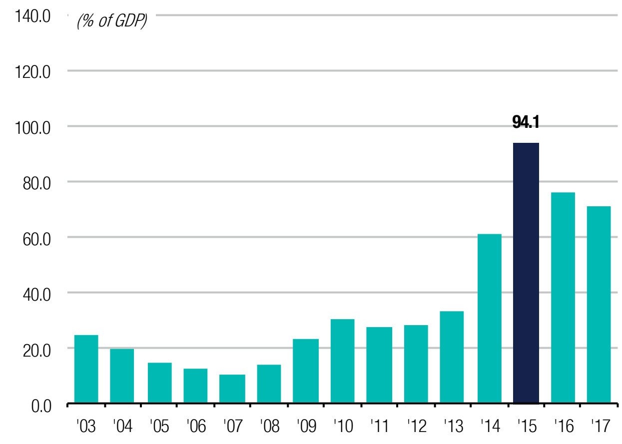
Chart 71. Public debt level as share of GDP: total debt, including direct and guaranteed debt (%, left) and direct debt (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

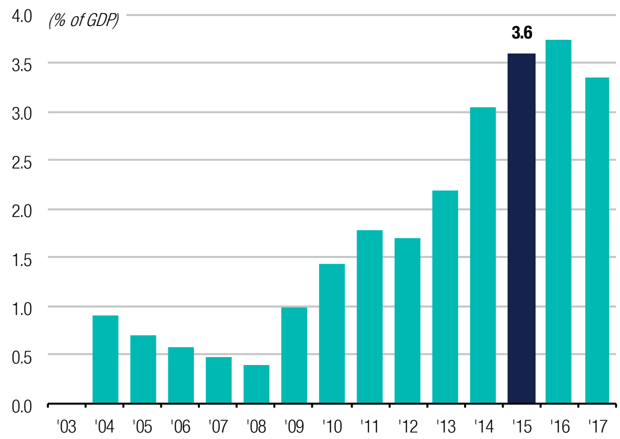
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

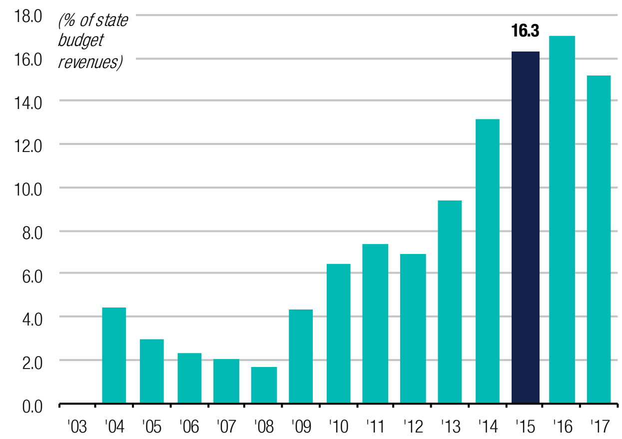
Chart 72. Debt service expenditures of the central government: as share of GDP (%, left) and as share of budget revenues (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

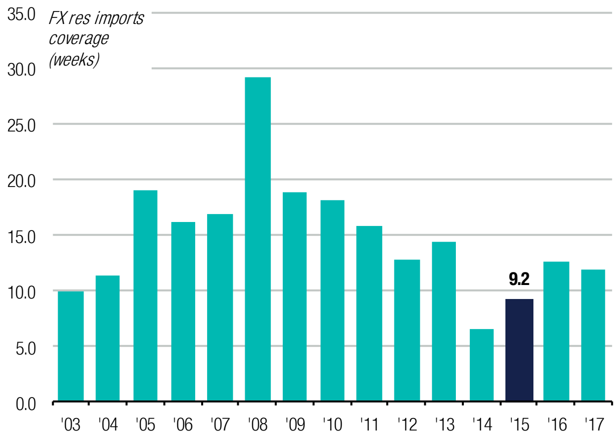
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

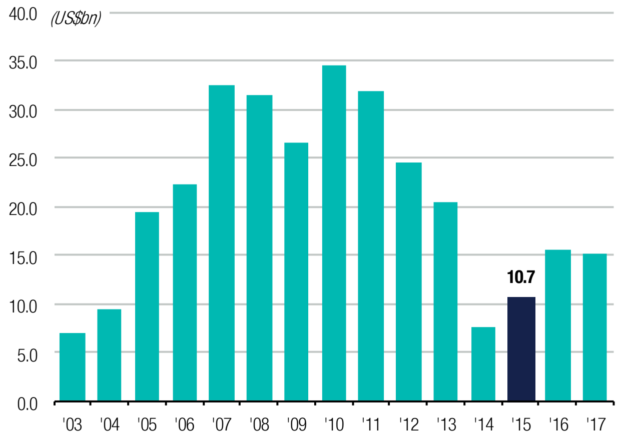
Chart 73. FX reserves: volume (US$bn, left) and ratio of imports coverage (weeks, right)

History from 2003 through 2014 and forecast for 2015-17



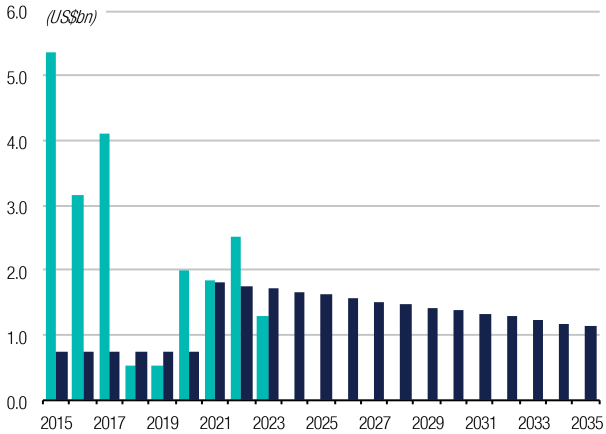
Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

History from 2003 through 2014 and forecast for 2015-17

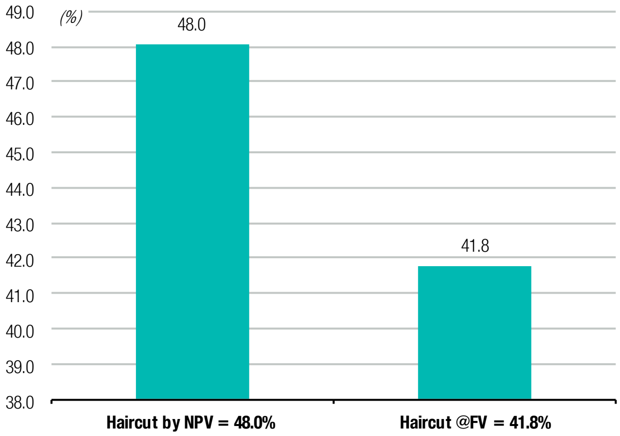


Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

Chart 74. Eurobond debt cash flow, interest and pricnicpal, before and after restructuring (US$bn, left) and NPV* of restructured debt as share of NPV of cash flow of 'old' debt and nominal value of 'old' debt (%, right)



Source: ICU.



Note: * 15% exit yield is assumed. Source: ICU.

Impact of external debt restructuring (scenario #2)

Macro: Average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH average FX rate in 2015, 2016 and 2017 is 25.25, 27 and 29.75.5 respectively. See Table 8 on p.45.

External debt restructuring: Sovereign Eurobonds are restructured with total face value of US$13.2bn (this excludes the US$1bn Eurobond backed by US government due in 2019 and the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed **coupon rate 4.5%**; redemption starts in 2021 by 15 equal installments each US$0.88bn a year. **No principal haircut**.

Table 20. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Activity															
Real GDP % YoY	9.6	12.1	2.7	7.3	7.9	2.3	-14.8	4.1	5.2	0.2	-0.1	-6.7	**-7.6**	**0.0**	**2.6**
Nominal GDP (UAHbn)	267.3	345.1	441.5	544.2	720.7	948.1	913.3	1,082.6	1,302.1	1,408.9	1,454.9	1,551.0	**1,903.4**	**2,298.5**	**2,744.8**
Nominal GDP (US$bn)	50.1	64.9	86.9	108.2	143.3	183.9	113.7	136.3	163.0	174.2	178.3	130.1	**75.3**	**84.9**	**92.1**
Nominal GDP @2002 prices	245.7	271.2	277.0	294.4	313.1	318.7	276.2	286.1	299.1	299.6	299.3	281.7	**265.3**	**265.3**	**271.1**
Inflation															
CPI headline (%YoY, eop)	8.2	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	**25.1**	**16.4**	**14.5**
CPI headline (%YoY, average)	5.2	9.0	13.6	9.1	12.8	25.3	16.0	9.4	8.0	0.6	-0.3	12.1	**29.0**	**17.9**	**15.0**
Index GDP defl avg @2002 prices	108.8	127.3	159.4	184.8	230.2	297.5	330.6	378.3	435.4	470.2	486.1	550.6	**717.5**	**866.5**	**1,012.5**
FX rate															
US$ in UAH (eop)	5.33	5.31	5.05	5.05	5.05	7.80	8.00	7.94	8.00	8.05	8.24	15.82	**26.00**	**28.00**	**30.00**
US$ in UAH (average)	5.33	5.32	5.10	5.03	5.03	5.25	8.03	7.94	7.99	8.08	8.16	12.00	**25.25**	**27.00**	**29.75**
Budget (UAHbn)															
Revenues	55.0	70.3	105.3	133.5	165.9	231.7	209.7	240.6	314.6	346.0	339.2	357.0	**420.6**	**507.5**	**605.9**
Expenditures	56.0	79.5	113.0	137.1	174.3	241.5	242.4	303.6	333.4	395.7	403.4	430.1	**563.2**	**591.2**	**691.6**
Balance	-1.0	-9.1	-7.6	-3.6	-8.3	-9.8	-32.7	-63.0	-18.8	-49.6	-64.2	-73.2	**-142.6**	**-83.7**	**-85.7**
Debt service	0.0	3.1	3.1	3.1	3.3	3.8	9.0	15.5	23.1	23.9	31.8	47.1	**67.5**	**85.8**	**91.6**
in local ccy	0.0	1.0	1.0	0.9	0.7	0.9	4.7	10.9	15.5	17.0	21.9	32.5	**34.9**	**45.1**	**52.7**
in foreign ccy	0.0	2.1	2.1	2.2	2.6	2.9	4.4	4.7	7.6	5.6	8.6	12.5	**32.6**	**40.8**	**39.0**
Primary expenditures	56.0	76.4	109.9	134.0	170.9	237.7	233.4	288.0	310.3	371.8	371.6	383.0	**495.7**	**505.3**	**600.0**
Primary expenditures @2002 prices	51.5	60.0	68.9	72.5	74.2	79.9	70.6	76.1	71.3	79.1	76.4	69.6	**69.1**	**58.3**	**59.3**
Primary balance	-1.0	-6.0	-4.5	-0.5	-5.0	-6.0	-23.7	-47.4	4.3	-25.8	-32.4	-26.1	**-75.1**	**2.1**	**5.9**
Naftogaz, Banks, SDGF fin req.	…	…	…	…	…	…	…	…	…	…	…	…	**150.0**	**50.0**	**50.0**
Net borrowing (historical data)															
Domestic borrowing (UAHbn)		4.1	7.2	1.6	3.6	25.3	62.3	70.7	53.6	67.6	109.8	227.3	**…**	**…**	**…**
External borrowing (US$bn)		1.1	0.7	1.9	1.2	0.0	4.7	6.6	2.8	4.9	6.0	7.2	**…**	**…**	**…**
Domestic redemptions (UAHbn)		1.3	2.5	4.7	3.5	5.9	13.5	30.9	47.4	53.5	66.8	98.9	**144.1**	**133.2**	**83.5**
External redemptions (US$bn)		0.1	0.2	0.2	0.3	0.4	1.6	0.9	2.0	4.1	5.5	4.9	**6.2**	**3.3**	**4.2**
Net dom borrowings (UAHbn)		2.9	4.7	-3.1	0.1	19.4	48.8	39.8	6.2	14.2	43.0	128.4	**…**	**…**	**…**
Net ext borrowings (US$bn)		1.0	0.6	1.7	0.9	-0.4	3.1	5.7	0.7	0.8	0.5	2.3	**…**	**…**	**…**
Budget (% of GDP)															
Revenues	20.6	20.4	23.9	24.5	23.0	24.4	23.0	22.2	24.2	24.6	23.3	23.0	**22.1**	**22.1**	**22.1**
Expenditures	20.9	23.0	25.6	25.2	24.2	25.5	26.5	28.0	25.6	28.1	27.7	27.7	**29.6**	**25.7**	**25.2**
Balance	-0.4	-2.6	-1.7	-0.7	-1.2	-1.0	-3.6	-5.8	-1.4	-3.5	-4.4	-4.7	**-7.5**	**-3.6**	**-3.1**
Debt service %GDP	0.0	0.9	0.7	0.6	0.5	0.4	1.0	1.4	1.8	1.7	2.2	3.0	**3.5**	**3.7**	**3.3**
Primary balance	-0.4	-1.7	-1.0	-0.1	-0.7	-0.6	-2.6	-4.4	0.3	-1.8	-2.2	-1.7	**-3.9**	**0.1**	**0.2**
Primary exp @2002 prices %GDP	20.9	22.1	24.9	24.6	23.7	25.1	25.6	26.6	23.8	26.4	25.5	24.7	**26.0**	**22.0**	**21.9**
Debt service / revenues %	0.0	4.4	3.0	2.3	2.0	1.6	4.3	6.5	7.4	6.9	9.4	13.2	**16.1**	**16.9**	**15.1**
Public debt															
Direct dom debt (UAHbn)	20.5	20.6	19.2	16.6	17.8	44.7	91.1	141.7	158.3	190.3	257.0	461.0	**753.6**	**887.3**	**1,023.0**

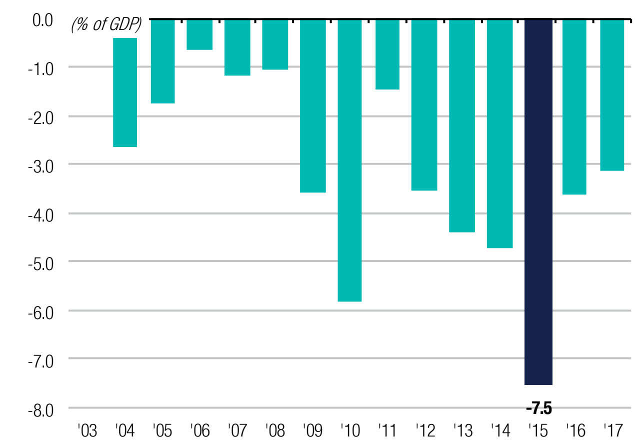
Table 20. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Direct ext debt (US$bn)	8.6	8.8	8.7	9.8	10.6	11.0	15.1	22.9	24.5	26.0	27.1	30.7	**39.9**	**30.7**	**30.7**
Guaranteed dom debt (UAHbn)	0.0	0.0	0.0	0.0	1.0	2.0	14.1	13.8	12.2	16.2	27.1	27.9	**29.9**	**31.9**	**33.9**
Guaranteed ext debt (US$bn)	2.1	3.3	3.0	2.9	3.3	7.3	9.5	12.0	13.0	12.4	9.3	8.0	**15.5**	**23.1**	**30.6**
Total (UAHbn)	77.5	85.0	78.1	80.5	88.7	189.4	301.5	432.2	469.9	515.5	584.1	1,100.6	**2,223.8**	**2,424.7**	**2,896.5**
Total debt (% of GDP)	29.0	24.6	17.7	14.8	12.3	20.0	33.0	39.9	36.1	36.6	40.1	71.0	**116.8**	**105.5**	**105.5**
Total direct (% of GDP)	24.7	19.5	14.3	12.1	9.9	13.8	23.2	29.9	27.2	28.3	33.0	61.0	**94.1**	**76.0**	**70.8**
Change															
Direct dom debt (UAHbn)		0.1	-1.4	-2.6	1.2	26.9	46.4	50.6	16.6	32.0	66.7	204.0	**292.6**	**133.7**	**135.7**
Direct ext debt (US$bn)		0.2	-0.1	1.1	0.8	0.4	4.0	7.8	1.6	1.5	1.1	3.6	**9.2**	**-9.2**	**0.0**
Guaranteed dom debt (UAHbn)		0.0	0.0	0.0	1.0	1.0	12.1	-0.2	-1.6	4.0	10.9	0.7	**2.0**	**2.0**	**2.0**
Guaranteed ext debt (US$bn)		1.2	-0.4	-0.1	0.4	4.0	2.2	2.5	1.0	-0.5	-3.1	-1.4	**7.6**	**7.6**	**7.6**
Total (UAHbn)		7.5	-6.9	2.4	8.2	100.7	112.1	130.7	37.7	45.6	68.6	516.4	**1,123.2**	**200.9**	**471.8**
Effective cost of public debt (%)															
Domestic		4.8	4.9	5.0	4.3	2.7	6.9	9.4	10.3	9.8	9.8	9.0	**9.0**	**9.0**	**9.0**
External		4.6	4.7	4.7	5.1	5.2	5.1	3.1	4.0	2.7	4.0	4.3	**4.3**	**4.3**	**4.3**
External balance															
FX res (US$bn)	6.9	9.5	19.4	22.3	32.5	31.5	26.5	34.6	31.8	24.5	20.4	7.5	**10.7**	**15.6**	**15.2**
Imports, goods+services (US$bn)	27.7	36.3	43.7	53.3	72.2	100.0	56.2	73.2	99.0	104.4	100.8	74.1	**61.0**	**60.4**	**64.2**
Imports cov (months)	2.3	2.6	4.4	3.7	3.9	6.7	4.3	4.2	3.7	2.9	3.3	1.5	**2.1**	**2.9**	**2.7**
Imports cov by FX res (weeks)	9.9	11.3	18.9	16.0	16.9	29.2	18.8	18.2	15.8	12.7	14.3	6.4	**9.2**	**12.6**	**11.8**

Sources: State Statistics Committee of Ukraine, Ministry of Finance of Ukraine, National Bank of Ukraine, ICU.

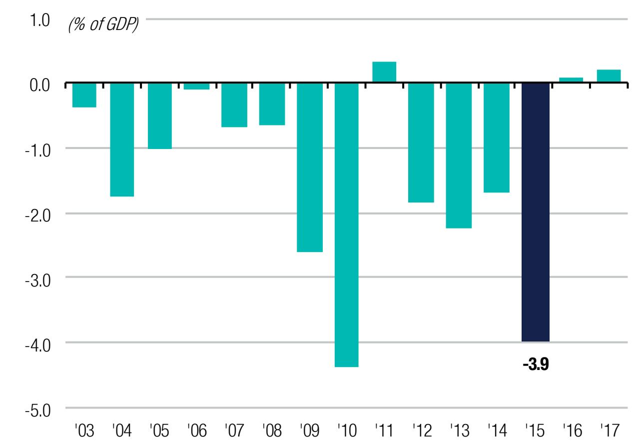
Chart 75. Budget balance of the central government(% GDP): total balance (left) and primary balance (right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

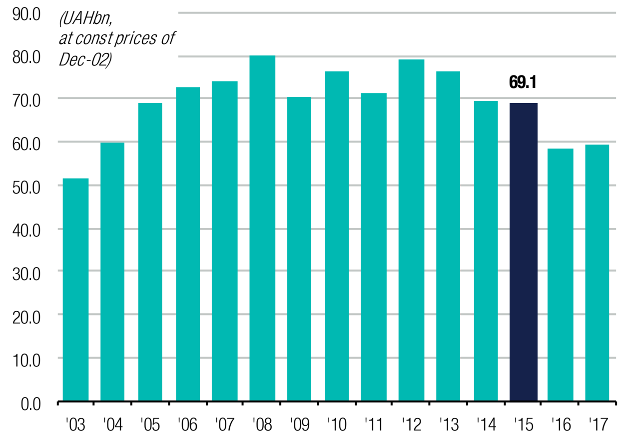
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

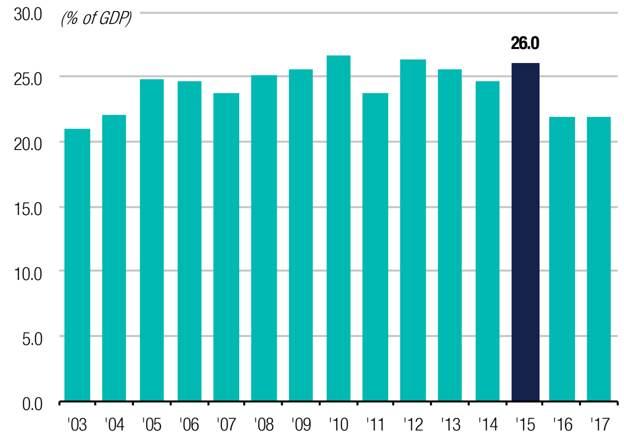
Chart 76. Budget expenditures of the central government: at constant prices of Dec-02 (UAHbn, left) and as share of GDP (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

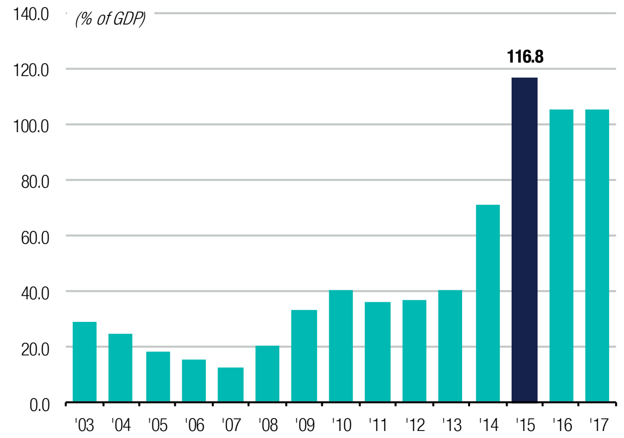
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

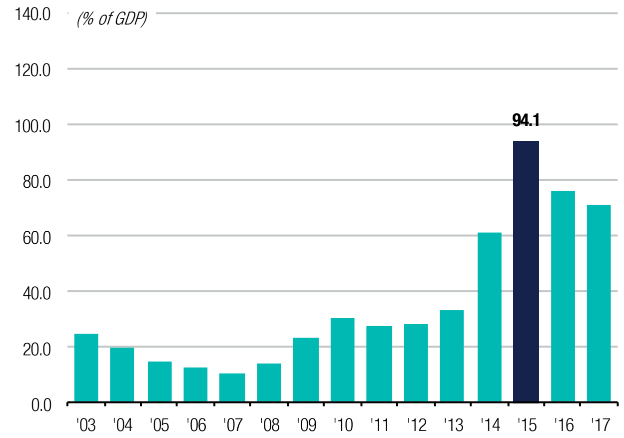
Chart 77. Public debt level as share of GDP: total debt, including direct and guaranteed debt (%, left) and direct debt (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

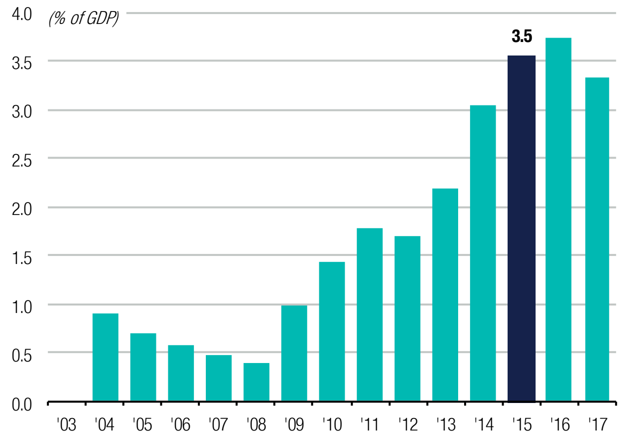
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

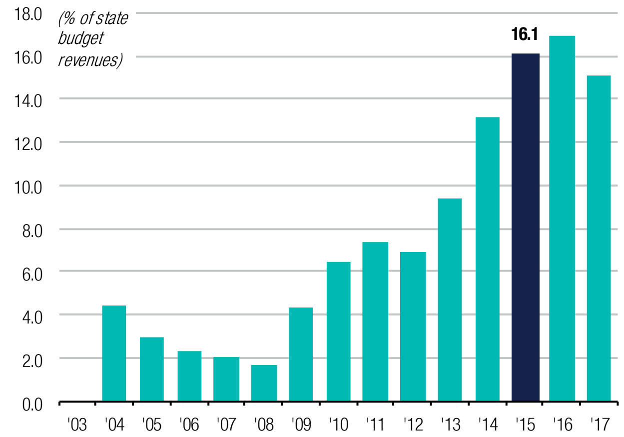
Chart 78. Debt service expenditures of the central government: as share of GDP (%, left) and as share of budget revenues (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

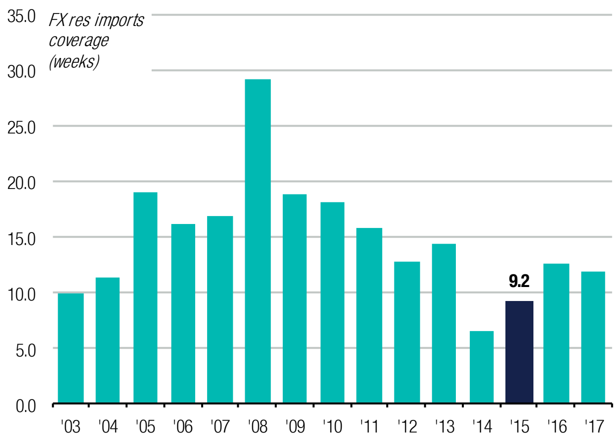
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

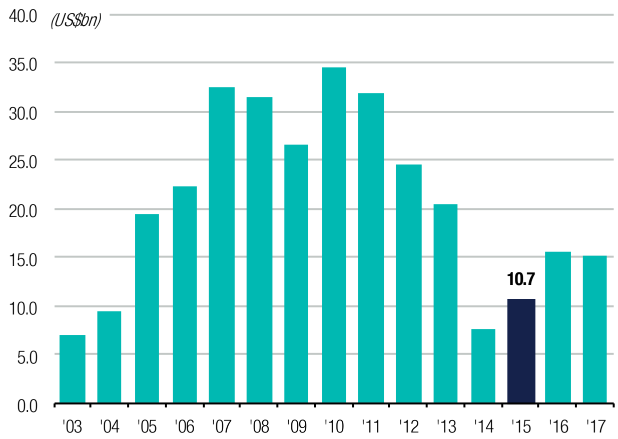
Chart 79. FX reserves: volume (US$bn, left) and ratio of imports coverage (weeks, right)

History from 2003 through 2014 and forecast for 2015-17



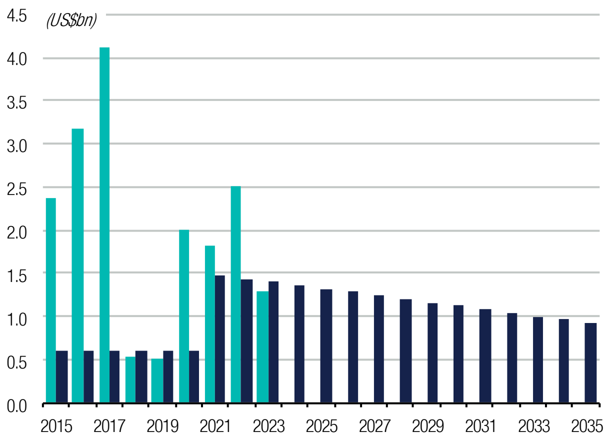
Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

History from 2003 through 2014 and forecast for 2015-17

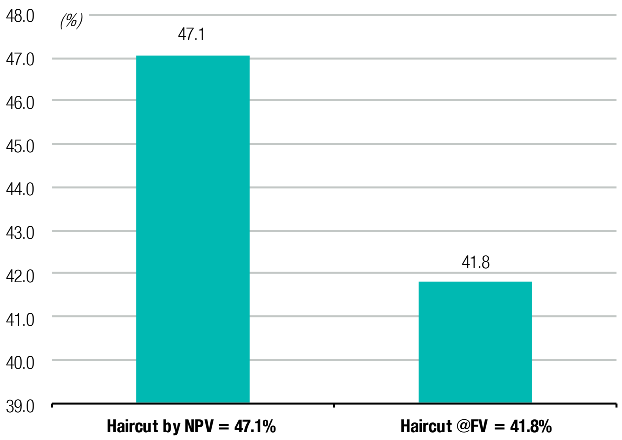


Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

Chart 80. Eurobond debt cash flow, interest and pricnicpal, before and after restructuring (US$bn, left) and NPV* of restructured debt as share of NPV of cash flow of 'old' debt and nominal value of 'old' debt (%, right)



Source: ICU.



Note: * 15% exit yield is assumed. Source: ICU.

Impact of external debt restructuring (scenario #3)

Macro: Average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH average FX rate in 2015, 2016 and 2017 is 25.25, 27 and 29.75.5 respectively. See Table 8 on p.45.

External debt restructuring: Sovereign Eurobonds are restructured with total face value of US$16.2bn (this excludes the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: **fixed coupon rate 4.5%**; redemption starts in 2021 by 15 equal installments each US$0.97bn a year. **10% principal haircut**.

Table 21. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Activity															
Real GDP % YoY	9.6	12.1	2.7	7.3	7.9	2.3	-14.8	4.1	5.2	0.2	-0.1	-6.7	**-7.6**	**0.0**	**2.6**
Nominal GDP (UAHbn)	267.3	345.1	441.5	544.2	720.7	948.1	913.3	1,082.6	1,302.1	1,408.9	1,454.9	1,551.0	**1,903.4**	**2,298.5**	**2,744.8**
Nominal GDP (US$bn)	50.1	64.9	86.9	108.2	143.3	183.9	113.7	136.3	163.0	174.2	178.3	130.1	**75.3**	**84.9**	**92.1**
Nominal GDP @2002 prices	245.7	271.2	277.0	294.4	313.1	318.7	276.2	286.1	299.1	299.6	299.3	281.7	**265.3**	**265.3**	**271.1**
Inflation															
CPI headline (%YoY, eop)	8.2	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	**25.1**	**16.4**	**14.5**
CPI headline (%YoY, average)	5.2	9.0	13.6	9.1	12.8	25.3	16.0	9.4	8.0	0.6	-0.3	12.1	**29.0**	**17.9**	**15.0**
Index GDP defl avg @2002 prices	108.8	127.3	159.4	184.8	230.2	297.5	330.6	378.3	435.4	470.2	486.1	550.6	**717.5**	**866.5**	**1,012.5**
FX rate															
US$ in UAH (eop)	5.33	5.31	5.05	5.05	5.05	7.80	8.00	7.94	8.00	8.05	8.24	15.82	**26.00**	**28.00**	**30.00**
US$ in UAH (average)	5.33	5.32	5.10	5.03	5.03	5.25	8.03	7.94	7.99	8.08	8.16	12.00	**25.25**	**27.00**	**29.75**
Budget (UAHbn)															
Revenues	55.0	70.3	105.3	133.5	165.9	231.7	209.7	240.6	314.6	346.0	339.2	357.0	**420.6**	**507.5**	**605.9**
Expenditures	56.0	79.5	113.0	137.1	174.3	241.5	242.4	303.6	333.4	395.7	403.4	430.1	**563.2**	**591.2**	**691.6**
Balance	-1.0	-9.1	-7.6	-3.6	-8.3	-9.8	-32.7	-63.0	-18.8	-49.6	-64.2	-73.2	**-142.6**	**-83.7**	**-85.7**
Debt service	0.0	3.1	3.1	3.1	3.3	3.8	9.0	15.5	23.1	23.9	31.8	47.1	**66.0**	**82.3**	**87.9**
in local ccy	0.0	1.0	1.0	0.9	0.7	0.9	4.7	10.9	15.5	17.0	21.9	32.5	**34.9**	**45.1**	**52.7**
in foreign ccy	0.0	2.1	2.1	2.2	2.6	2.9	4.4	4.7	7.6	5.6	8.6	12.5	**31.2**	**37.3**	**35.2**
Primary expenditures	56.0	76.4	109.9	134.0	170.9	237.7	233.4	288.0	310.3	371.8	371.6	383.0	**497.2**	**508.8**	**603.8**
Primary expenditures @2002 prices	51.5	60.0	68.9	72.5	74.2	79.9	70.6	76.1	71.3	79.1	76.4	69.6	**69.3**	**58.7**	**59.6**
Primary balance	-1.0	-6.0	-4.5	-0.5	-5.0	-6.0	-23.7	-47.4	4.3	-25.8	-32.4	-26.1	**-76.5**	**-1.4**	**2.1**
Naftogaz, Banks, SDGF fin req.	…	…	…	…	…	…	…	…	…	…	…	…	**150.0**	**50.0**	**50.0**
Net borrowing (historical data)															
Domestic borrowing (UAHbn)		4.1	7.2	1.6	3.6	25.3	62.3	70.7	53.6	67.6	109.8	227.3	…	…	…
External borrowing (US$bn)		1.1	0.7	1.9	1.2	0.0	4.7	6.6	2.8	4.9	6.0	7.2	…	…	…
Domestic redemptions (UAHbn)		1.3	2.5	4.7	3.5	5.9	13.5	30.9	47.4	53.5	66.8	98.9	**144.1**	**133.2**	**83.5**
External redemptions (US$bn)		0.1	0.2	0.2	0.3	0.4	1.6	0.9	2.0	4.1	5.5	4.9	**6.2**	**3.3**	**4.2**
Net dom borrowings (UAHbn)		2.9	4.7	-3.1	0.1	19.4	48.8	39.8	6.2	14.2	43.0	128.4	…	…	…
Net ext borrowings (US$bn)		1.0	0.6	1.7	0.9	-0.4	3.1	5.7	0.7	0.8	0.5	2.3	…	…	…
Budget (% of GDP)															
Revenues	20.6	20.4	23.9	24.5	23.0	24.4	23.0	22.2	24.2	24.6	23.3	23.0	**22.1**	**22.1**	**22.1**
Expenditures	20.9	23.0	25.6	25.2	24.2	25.5	26.5	28.0	25.6	28.1	27.7	27.7	**29.6**	**25.7**	**25.2**
Balance	-0.4	-2.6	-1.7	-0.7	-1.2	-1.0	-3.6	-5.8	-1.4	-3.5	-4.4	-4.7	**-7.5**	**-3.6**	**-3.1**
Debt service %GDP	0.0	0.9	0.7	0.6	0.5	0.4	1.0	1.4	1.8	1.7	2.2	3.0	**3.5**	**3.6**	**3.2**
Primary balance	-0.4	-1.7	-1.0	-0.1	-0.7	-0.6	-2.6	-4.4	0.3	-1.8	-2.2	-1.7	**-4.0**	**-0.1**	**0.1**
Primary exp @2002 prices %GDP	20.9	22.1	24.9	24.6	23.7	25.1	25.6	26.6	23.8	26.4	25.5	24.7	**26.1**	**22.1**	**22.0**
Debt service / revenues %	0.0	4.4	3.0	2.3	2.0	1.6	4.3	6.5	7.4	6.9	9.4	13.2	**15.7**	**16.2**	**14.5**
Public debt													**14.5**	**14.5**	**14.5**
Direct dom debt (UAHbn)	20.5	20.6	19.2	16.6	17.8	44.7	91.1	141.7	158.3	190.3	257.0	461.0	**753.6**	**887.3**	**1,023.0**

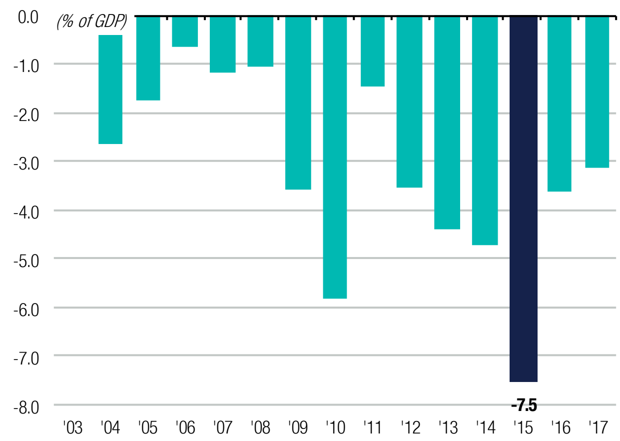
Table 21. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Direct ext debt (US$bn)	8.6	8.8	8.7	9.8	10.6	11.0	15.1	22.9	24.5	26.0	27.1	30.7	**38.3**	**29.1**	**29.1**
Guaranteed dom debt (UAHbn)	0.0	0.0	0.0	0.0	1.0	2.0	14.1	13.8	12.2	16.2	27.1	27.9	**29.9**	**31.9**	**33.9**
Guaranteed ext debt (US$bn)	2.1	3.3	3.0	2.9	3.3	7.3	9.5	12.0	13.0	12.4	9.3	8.0	**15.5**	**23.1**	**30.6**
Total (UAHbn)	77.5	85.0	78.1	80.5	88.7	189.4	301.5	432.2	469.9	515.5	584.1	1,100.6	**2,181.5**	**2,379.2**	**2,847.8**
Total debt (% of GDP)	29.0	24.6	17.7	14.8	12.3	20.0	33.0	39.9	36.1	36.6	40.1	71.0	**114.6**	**103.5**	**103.8**
Total direct (% of GDP)	24.7	19.5	14.3	12.1	9.9	13.8	23.2	29.9	27.2	28.3	33.0	61.0	**91.9**	**74.0**	**69.1**
Change															
Direct dom debt (UAHbn)		0.1	-1.4	-2.6	1.2	26.9	46.4	50.6	16.6	32.0	66.7	204.0	**292.6**	**133.7**	**135.7**
Direct ext debt (US$bn)		0.2	-0.1	1.1	0.8	0.4	4.0	7.8	1.6	1.5	1.1	3.6	**7.6**	**-9.2**	**0.0**
Guaranteed dom debt (UAHbn)		0.0	0.0	0.0	1.0	1.0	12.1	-0.2	-1.6	4.0	10.9	0.7	**2.0**	**2.0**	**2.0**
Guaranteed ext debt (US$bn)		1.2	-0.4	-0.1	0.4	4.0	2.2	2.5	1.0	-0.5	-3.1	-1.4	**7.6**	**7.6**	**7.6**
Total (UAHbn)		7.5	-6.9	2.4	8.2	100.7	112.1	130.7	37.7	45.6	68.6	516.4	**1,081.0**	**197.7**	**468.6**
Effective cost of public debt (%)															
Domestic		4.8	4.9	5.0	4.3	2.7	6.9	9.4	10.3	9.8	9.8	9.0	**9.0**	**9.0**	**9.0**
External		4.6	4.7	4.7	5.1	5.2	5.1	3.1	4.0	2.7	4.0	4.3	**4.3**	**4.3**	**4.3**
External balance															
FX res (US$bn)	6.9	9.5	19.4	22.3	32.5	31.5	26.5	34.6	31.8	24.5	20.4	7.5	**10.7**	**15.6**	**15.2**
Imports, goods+services (US$bn)	27.7	36.3	43.7	53.3	72.2	100.0	56.2	73.2	99.0	104.4	100.8	74.1	**61.0**	**60.4**	**64.2**
Imports cov (months)	2.3	2.6	4.4	3.7	3.9	6.7	4.3	4.2	3.7	2.9	3.3	1.5	**2.1**	**2.9**	**2.7**
Imports cov by FX res (weeks)	9.9	11.3	18.9	16.0	16.9	29.2	18.8	18.2	15.8	12.7	14.3	6.4	**9.2**	**12.6**	**11.8**

Sources: State Statistics Committee of Ukraine, Ministry of Finance of Ukraine, National Bank of Ukraine, ICU.

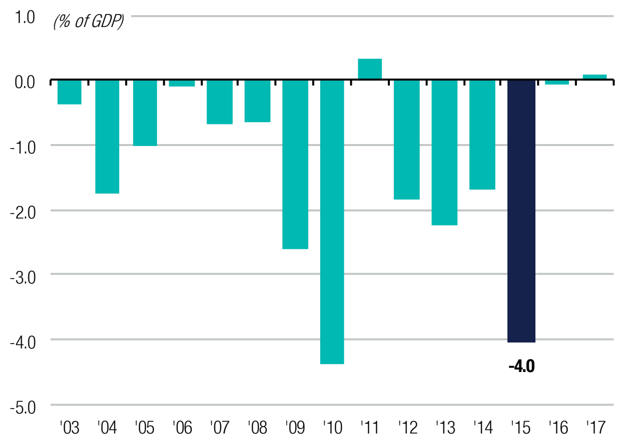
Chart 81. Budget balance of the central government(% GDP): Total balance (left) and primary balance (right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

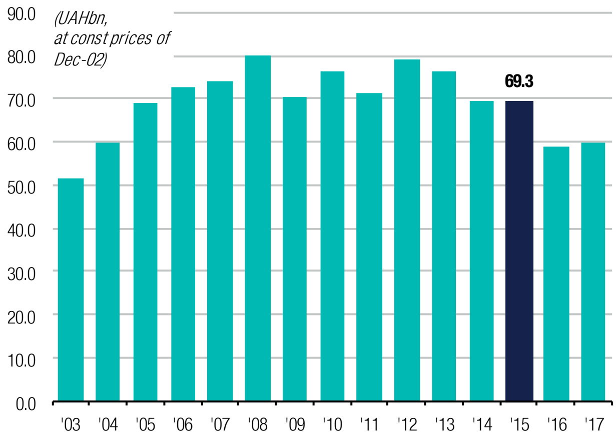
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

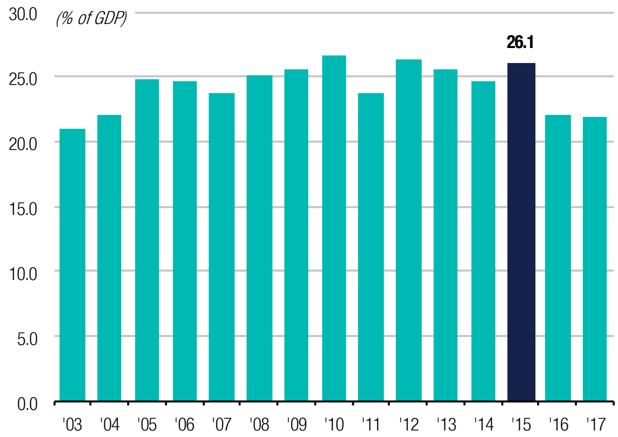
Chart 82. Budget expenditures of the central government at constant prices of Dec-02 (UAHbn, left) and as share of GDP (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

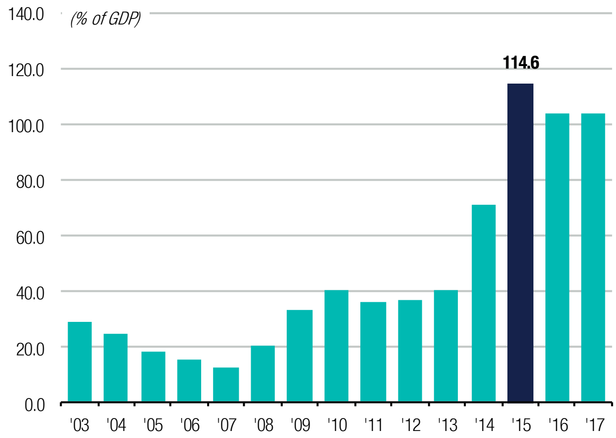
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

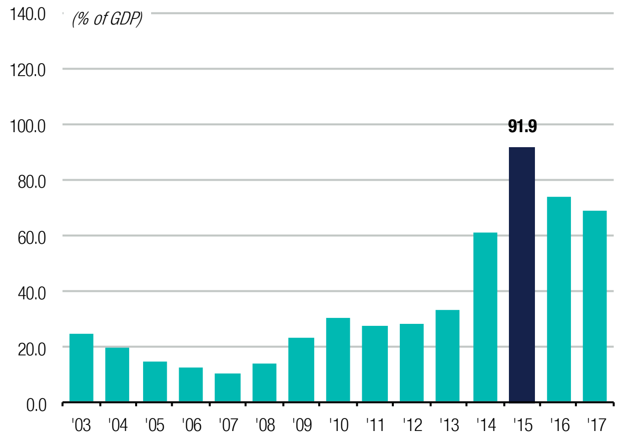
Chart 83. Public debt level as share of GDP: Total debt, including direct and guaranteed debt (%, left) and direct debt (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

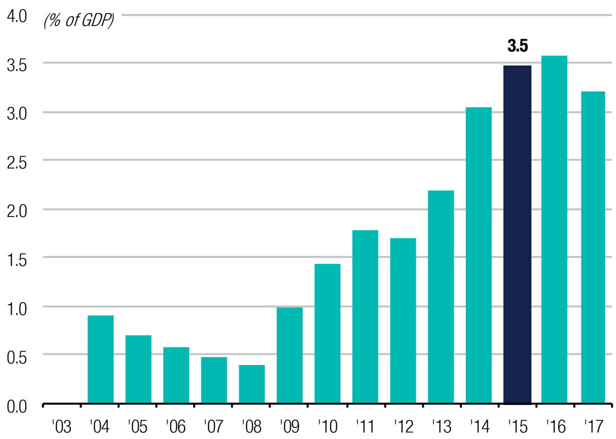
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

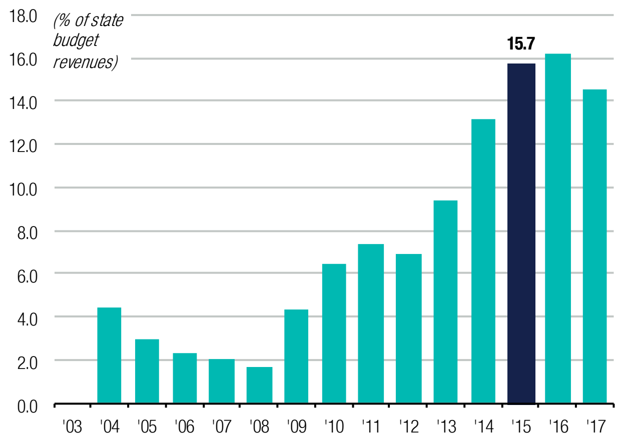
Chart 84. Debt service expenditures of the central government as share of GDP (%, left) and as share of budget revenues (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

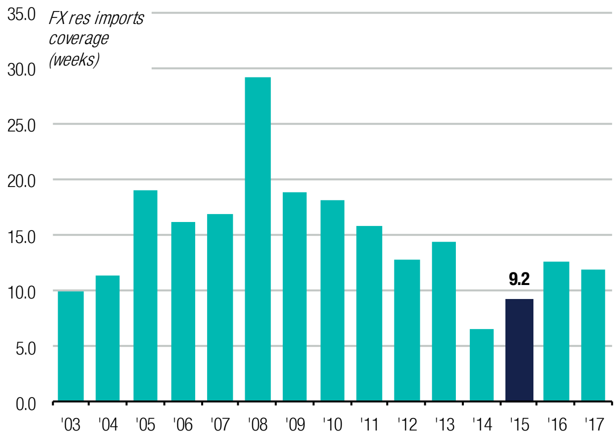
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

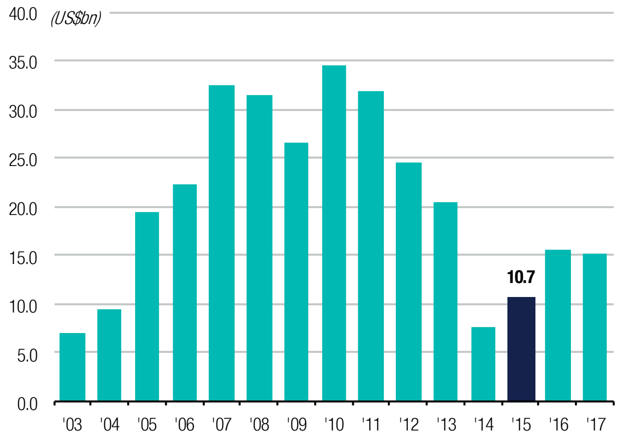
Chart 85. FX reserves: volume (US$bn, left) and ratio of imports coverage (weeks, right)

History from 2003 through 2014 and forecast for 2015-17



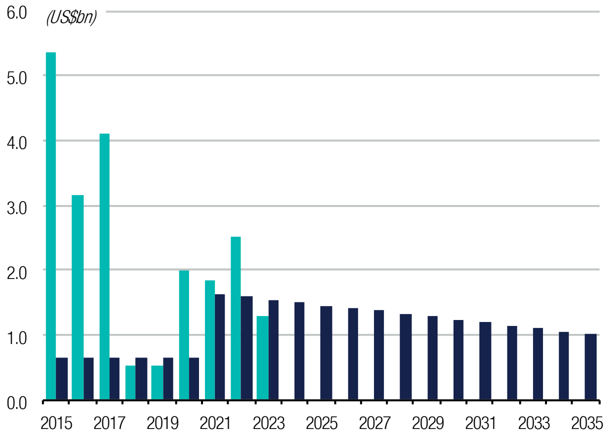
Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

History from 2003 through 2014 and forecast for 2015-17

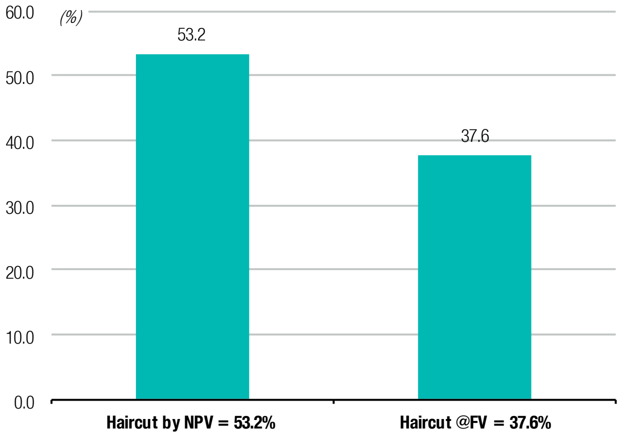


Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

Chart 86. Eurobond debt cash flow, interest and pricnicpal, before and after restructuring (US$bn, left) and NPV* of restructured debt as share of NPV of cash flow of 'old' debt and nominal value of 'old' debt (%, right)



Source: ICU.



Note: * 15% exit yield is assumed. Source: ICU.

Impact of external debt restructuring (scenario #4)

Macro: Average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH average FX rate in 2015, 2016 and 2017 is 25.25, 27 and 29.75.5 respectively. See Table 8 on p.45.

External debt restructuring: Sovereign Eurobonds are restructured with total face value of US$16.2bn (this excludes the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed **coupon rate 4.5%**; redemption starts in 2021 by 15 equal installments each US$0.87bn a year. **20% principal haircut**.

Table 22. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Activity															
Real GDP % YoY	9.6	12.1	2.7	7.3	7.9	2.3	-14.8	4.1	5.2	0.2	-0.1	-6.7	**-7.6**	**0.0**	**2.6**
Nominal GDP (UAHbn)	267.3	345.1	441.5	544.2	720.7	948.1	913.3	1,082.6	1,302.1	1,408.9	1,454.9	1,551.0	**1,903.4**	**2,298.5**	**2,744.8**
Nominal GDP (US$bn)	50.1	64.9	86.9	108.2	143.3	183.9	113.7	136.3	163.0	174.2	178.3	130.1	**75.3**	**84.9**	**92.1**
Nominal GDP @2002 prices	245.7	271.2	277.0	294.4	313.1	318.7	276.2	286.1	299.1	299.6	299.3	281.7	**265.3**	**265.3**	**271.1**
Inflation															
CPI headline (%YoY, eop)	8.2	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	**25.1**	**16.4**	**14.5**
CPI headline (%YoY, average)	5.2	9.0	13.6	9.1	12.8	25.3	16.0	9.4	8.0	0.6	-0.3	12.1	**29.0**	**17.9**	**15.0**
Index GDP defl avg @2002 prices	108.8	127.3	159.4	184.8	230.2	297.5	330.6	378.3	435.4	470.2	486.1	550.6	**717.5**	**866.5**	**1,012.5**
FX rate															
US$ in UAH (eop)	5.33	5.31	5.05	5.05	5.05	7.80	8.00	7.94	8.00	8.05	8.24	15.82	**26.00**	**28.00**	**30.00**
US$ in UAH (average)	5.33	5.32	5.10	5.03	5.03	5.25	8.03	7.94	7.99	8.08	8.16	12.00	**25.25**	**27.00**	**29.75**
Budget (UAHbn)															
Revenues	55.0	70.3	105.3	133.5	165.9	231.7	209.7	240.6	314.6	346.0	339.2	357.0	**420.6**	**507.5**	**605.9**
Expenditures	56.0	79.5	113.0	137.1	174.3	241.5	242.4	303.6	333.4	395.7	403.4	430.1	**563.2**	**591.2**	**691.6**
Balance	-1.0	-9.1	-7.6	-3.6	-8.3	-9.8	-32.7	-63.0	-18.8	-49.6	-64.2	-73.2	**-142.6**	**-83.7**	**-85.7**
Debt service	0.0	3.1	3.1	3.1	3.3	3.8	9.0	15.5	23.1	23.9	31.8	47.1	**63.6**	**78.5**	**83.7**
in local ccy	0.0	1.0	1.0	0.9	0.7	0.9	4.7	10.9	15.5	17.0	21.9	32.5	**34.9**	**45.1**	**52.7**
in foreign ccy	0.0	2.1	2.1	2.2	2.6	2.9	4.4	4.7	7.6	5.6	8.6	12.5	**28.7**	**33.5**	**31.0**
Primary expenditures	56.0	76.4	109.9	134.0	170.9	237.7	233.4	288.0	310.3	371.8	371.6	383.0	**499.7**	**512.6**	**607.9**
Primary expenditures @2002 prices	51.5	60.0	68.9	72.5	74.2	79.9	70.6	76.1	71.3	79.1	76.4	69.6	**69.6**	**59.2**	**60.0**
Primary balance	-1.0	-6.0	-4.5	-0.5	-5.0	-6.0	-23.7	-47.4	4.3	-25.8	-32.4	-26.1	**-79.0**	**-5.2**	**-2.0**
Naftogaz, Banks, SDGF fin req.	…	…	…	…	…	…	…	…	…	…	…	…	**150.0**	**50.0**	**50.0**
Net borrowing (historical data)															
Domestic borrowing (UAHbn)		4.1	7.2	1.6	3.6	25.3	62.3	70.7	53.6	67.6	109.8	227.3	…	…	…
External borrowing (US$bn)		1.1	0.7	1.9	1.2	0.0	4.7	6.6	2.8	4.9	6.0	7.2	…	…	…
Domestic redemptions (UAHbn)		1.3	2.5	4.7	3.5	5.9	13.5	30.9	47.4	53.5	66.8	98.9	**144.1**	**133.2**	**83.5**
External redemptions (US$bn)		0.1	0.2	0.2	0.3	0.4	1.6	0.9	2.0	4.1	5.5	4.9	**6.2**	**3.3**	**4.2**
Net dom borrowings (UAHbn)		2.9	4.7	-3.1	0.1	19.4	48.8	39.8	6.2	14.2	43.0	128.4	…	…	…
Net ext borrowings (US$bn)		1.0	0.6	1.7	0.9	-0.4	3.1	5.7	0.7	0.8	0.5	2.3	…	…	…
Budget (% of GDP)															
Revenues	20.6	20.4	23.9	24.5	23.0	24.4	23.0	22.2	24.2	24.6	23.3	23.0	**22.1**	**22.1**	**22.1**
Expenditures	20.9	23.0	25.6	25.2	24.2	25.5	26.5	28.0	25.6	28.1	27.7	27.7	**29.6**	**25.7**	**25.2**
Balance	-0.4	-2.6	-1.7	-0.7	-1.2	-1.0	-3.6	-5.8	-1.4	-3.5	-4.4	-4.7	**-7.5**	**-3.6**	**-3.1**
Debt service %GDP	0.0	0.9	0.7	0.6	0.5	0.4	1.0	1.4	1.8	1.7	2.2	3.0	**3.3**	**3.4**	**3.0**
Primary balance	-0.4	-1.7	-1.0	-0.1	-0.7	-0.6	-2.6	-4.4	0.3	-1.8	-2.2	-1.7	**-4.2**	**-0.2**	**-0.1**
Primary exp @2002 prices %GDP	20.9	22.1	24.9	24.6	23.7	25.1	25.6	26.6	23.8	26.4	25.5	24.7	**26.3**	**22.3**	**22.1**
Debt service / revenues %	0.0	4.4	3.0	2.3	2.0	1.6	4.3	6.5	7.4	6.9	9.4	13.2	**15.1**	**15.5**	**13.8**
Public debt													**14.5**	**14.5**	**14.5**
Direct dom debt (UAHbn)	20.5	20.6	19.2	16.6	17.8	44.7	91.1	141.7	158.3	190.3	257.0	461.0	**753.6**	**887.3**	**1,023.0**

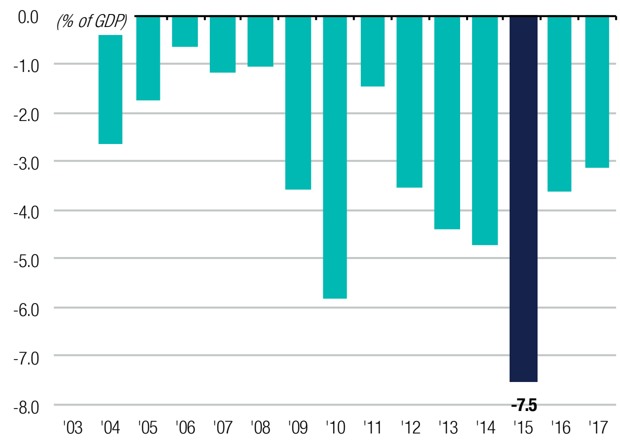
Table 22. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Direct ext debt (US$bn)	8.6	8.8	8.7	9.8	10.6	11.0	15.1	22.9	24.5	26.0	27.1	30.7	**36.6**	**27.5**	**27.5**
Guaranteed dom debt (UAHbn)	0.0	0.0	0.0	0.0	1.0	2.0	14.1	13.8	12.2	16.2	27.1	27.9	**29.9**	**31.9**	**33.9**
Guaranteed ext debt (US$bn)	2.1	3.3	3.0	2.9	3.3	7.3	9.5	12.0	13.0	12.4	9.3	8.0	**15.5**	**23.1**	**30.6**
Total (UAHbn)	77.5	85.0	78.1	80.5	88.7	189.4	301.5	432.2	469.9	515.5	584.1	1,100.6	**2,139.3**	**2,333.7**	**2,799.0**
Total debt (% of GDP)	29.0	24.6	17.7	14.8	12.3	20.0	33.0	39.9	36.1	36.6	40.1	71.0	**112.4**	**101.5**	**102.0**
Total direct (% of GDP)	24.7	19.5	14.3	12.1	9.9	13.8	23.2	29.9	27.2	28.3	33.0	61.0	**89.6**	**72.1**	**67.3**
Change															
Direct dom debt (UAHbn)		0.1	-1.4	-2.6	1.2	26.9	46.4	50.6	16.6	32.0	66.7	204.0	**292.6**	**133.7**	**135.7**
Direct ext debt (US$bn)		0.2	-0.1	1.1	0.8	0.4	4.0	7.8	1.6	1.5	1.1	3.6	**5.9**	**-9.2**	**0.0**
Guaranteed dom debt (UAHbn)		0.0	0.0	0.0	1.0	1.0	12.1	-0.2	-1.6	4.0	10.9	0.7	**2.0**	**2.0**	**2.0**
Guaranteed ext debt (US$bn)		1.2	-0.4	-0.1	0.4	4.0	2.2	2.5	1.0	-0.5	-3.1	-1.4	**7.6**	**7.6**	**7.6**
Total (UAHbn)		7.5	-6.9	2.4	8.2	100.7	112.1	130.7	37.7	45.6	68.6	516.4	**1,038.7**	**194.4**	**465.3**
Effective cost of public debt (%)															
Domestic		4.8	4.9	5.0	4.3	2.7	6.9	9.4	10.3	9.8	9.8	9.0	**9.0**	**9.0**	**9.0**
External		4.6	4.7	4.7	5.1	5.2	5.1	3.1	4.0	2.7	4.0	4.3	**4.3**	**4.3**	**4.3**
External balance															
FX res (US$bn)	6.9	9.5	19.4	22.3	32.5	31.5	26.5	34.6	31.8	24.5	20.4	7.5	**10.7**	**15.6**	**15.2**
Imports, goods+services (US$bn)	27.7	36.3	43.7	53.3	72.2	100.0	56.2	73.2	99.0	104.4	100.8	74.1	**61.0**	**60.4**	**64.2**
Imports cov (months)	2.3	2.6	4.4	3.7	3.9	6.7	4.3	4.2	3.7	2.9	3.3	1.5	**2.1**	**2.9**	**2.7**
Imports cov by FX res (weeks)	9.9	11.3	18.9	16.0	16.9	29.2	18.8	18.2	15.8	12.7	14.3	6.4	**9.2**	**12.6**	**11.8**

Sources: State Statistics Committee of Ukraine, Ministry of Finance of Ukraine, National Bank of Ukraine, ICU.

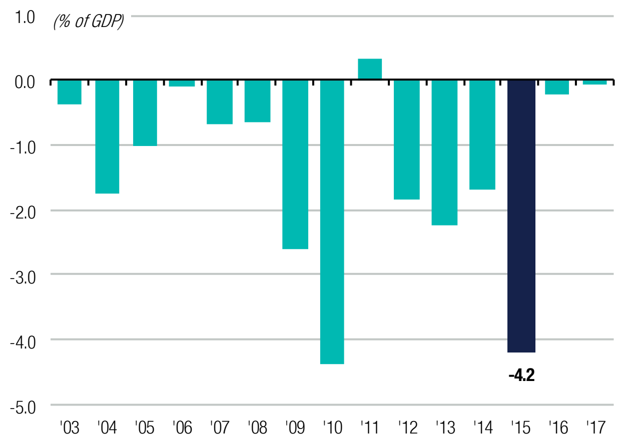
Chart 87. Budget balance of the central government(% GDP): Total balance (left) and primary balance (right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

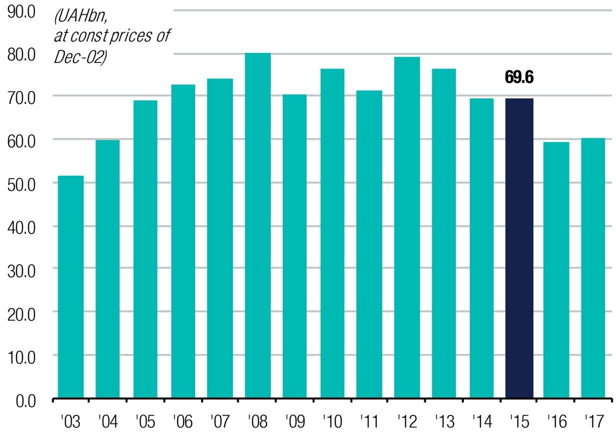
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

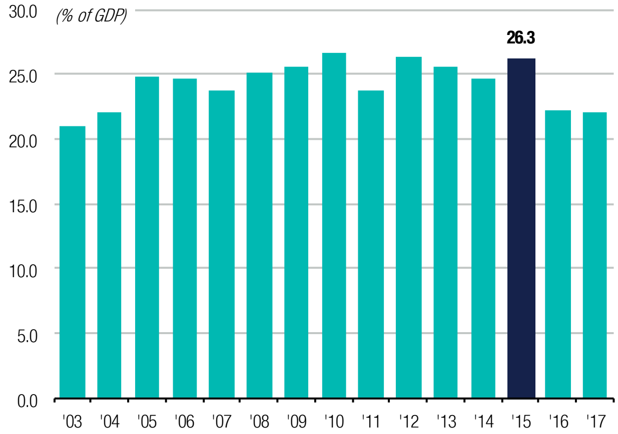
Chart 88. Budget expenditures of the central government: at constant prices of Dec-02 (UAHbn, left) and as share of GDP (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

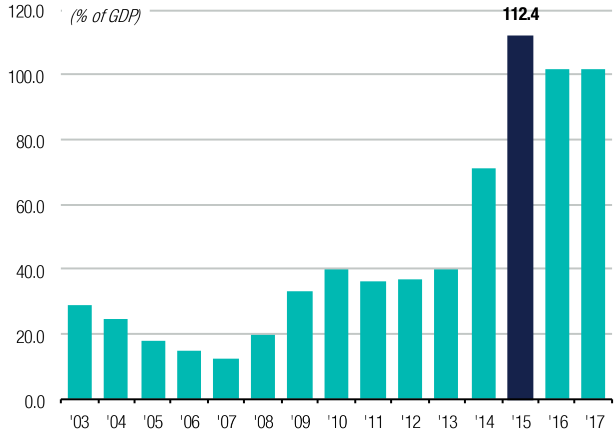
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

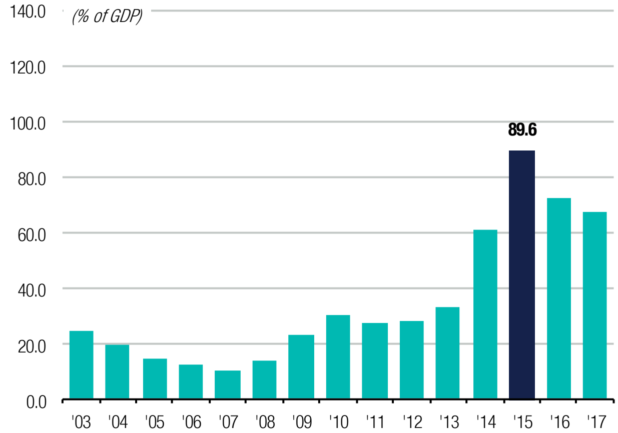
Chart 89. Public debt level as share of GDP: Total debt, including direct and guaranteed debt (%, left) and direct debt (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

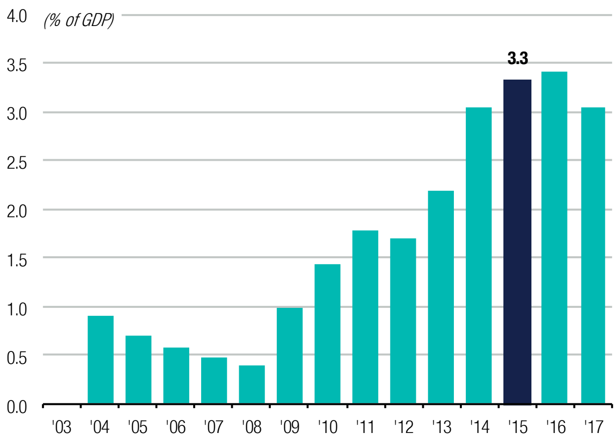
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

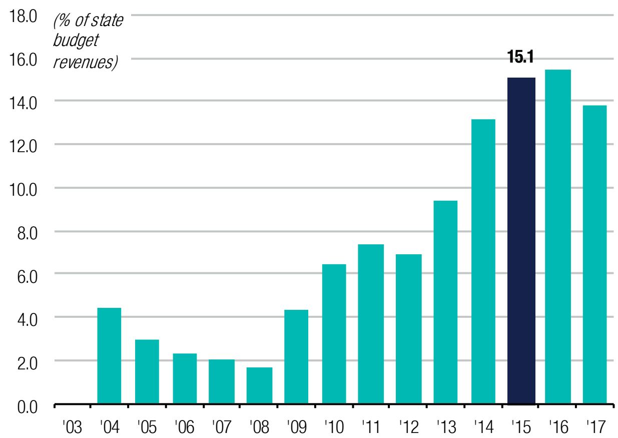
Chart 90. Debt service expenditures of the central government as share of GDP (%, left) and as share of budget revenues (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

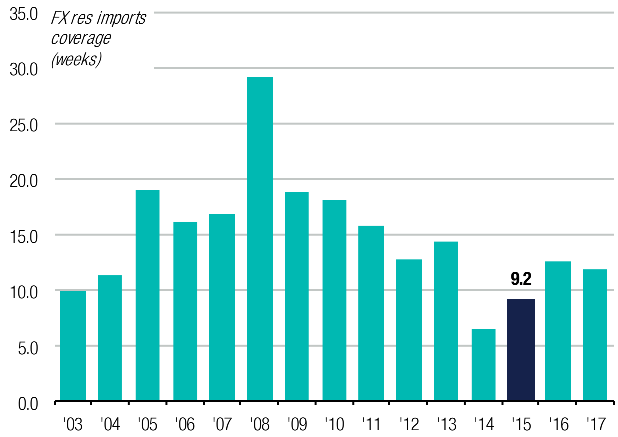
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

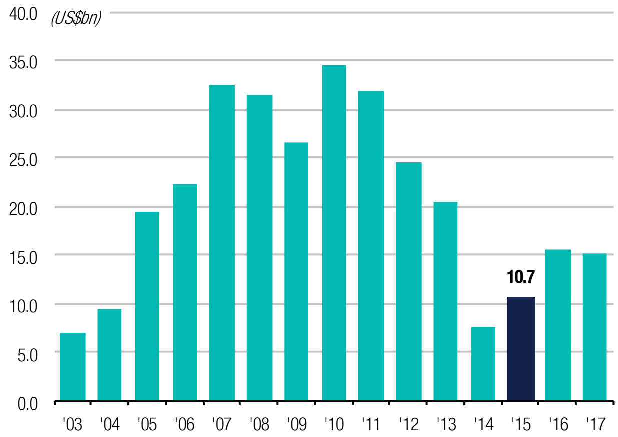
Chart 91. FX reserves: volume (US$bn, left) and ratio of imports coverage (weeks, right)

History from 2003 through 2014 and forecast for 2015-17



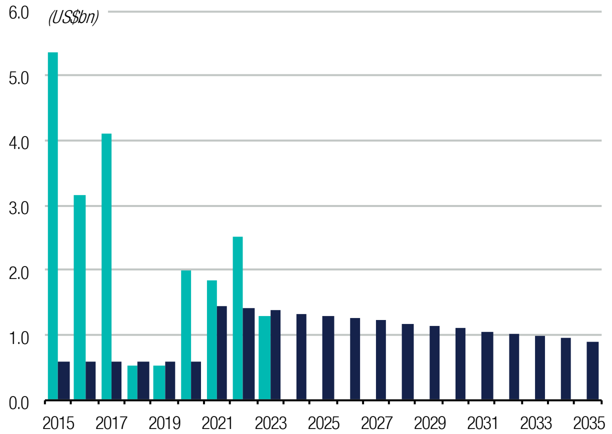
Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

History from 2003 through 2014 and forecast for 2015-17

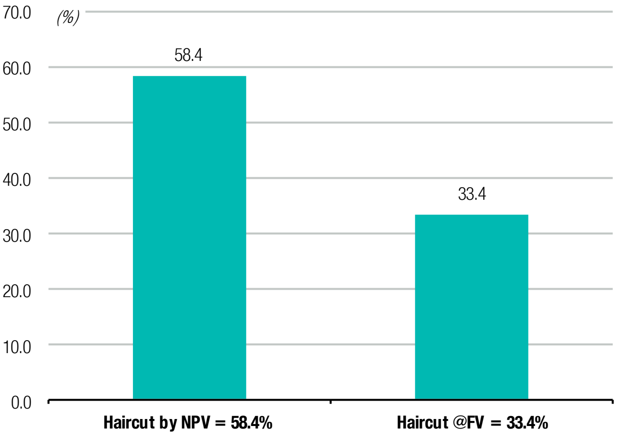


Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

Chart 92. Eurobond debt cash flow, interest and principal, before and after restructuring (US$bn, left) and NPV* of restructured debt as share of NPV of cash flow of 'old' debt and nominal value of 'old' debt (%, right)



Source: ICU.



Note: * 15% exit yield is assumed. Source: ICU.

Impact of external debt restructuring (scenario #5)

Macro: Average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH average FX rate in 2015, 2016 and 2017 is 25.25, 27 and 29.75.5 respectively. See Table 8 on p.45.

External debt restructuring: Sovereign Eurobonds are restructured with total face value of US$16.2bn (this does exclude the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed **coupon rate 4.5%**; redemption starts in 2021 by 15 equal installments each US$0.76bn a year. **30% principal haircut.**

Table 23. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Activity															
Real GDP % YoY	9.6	12.1	2.7	7.3	7.9	2.3	-14.8	4.1	5.2	0.2	-0.1	-6.7	**-7.6**	**0.0**	**2.6**
Nominal GDP (UAHbn)	267.3	345.1	441.5	544.2	720.7	948.1	913.3	1,082.6	1,302.1	1,408.9	1,454.9	1,551.0	**1,903.4**	**2,298.5**	**2,744.8**
Nominal GDP (US$bn)	50.1	64.9	86.9	108.2	143.3	183.9	113.7	136.3	163.0	174.2	178.3	130.1	**75.3**	**84.9**	**92.1**
Nominal GDP @2002 prices	245.7	271.2	277.0	294.4	313.1	318.7	276.2	286.1	299.1	299.6	299.3	281.7	**265.3**	**265.3**	**271.1**
Inflation															
CPI headline (%YoY, eop)	8.2	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	**25.1**	**16.4**	**14.5**
CPI headline (%YoY, average)	5.2	9.0	13.6	9.1	12.8	25.3	16.0	9.4	8.0	0.6	-0.3	12.1	**29.0**	**17.9**	**15.0**
Index GDP defl avg @2002 prices	108.8	127.3	159.4	184.8	230.2	297.5	330.6	378.3	435.4	470.2	486.1	550.6	**717.5**	**866.5**	**1,012.5**
FX rate															
US$ in UAH (eop)	5.33	5.31	5.05	5.05	5.05	7.80	8.00	7.94	8.00	8.05	8.24	15.82	**26.00**	**28.00**	**30.00**
US$ in UAH (average)	5.33	5.32	5.10	5.03	5.03	5.25	8.03	7.94	7.99	8.08	8.16	12.00	**25.25**	**27.00**	**29.75**
Budget (UAHbn)															
Revenues	55.0	70.3	105.3	133.5	165.9	231.7	209.7	240.6	314.6	346.0	339.2	357.0	**420.6**	**507.5**	**605.9**
Expenditures	56.0	79.5	113.0	137.1	174.3	241.5	242.4	303.6	333.4	395.7	403.4	430.1	**563.2**	**591.2**	**691.6**
Balance	-1.0	-9.1	-7.6	-3.6	-8.3	-9.8	-32.7	-63.0	-18.8	-49.6	-64.2	-73.2	**-142.6**	**-83.7**	**-85.7**
Debt service	0.0	3.1	3.1	3.1	3.3	3.8	9.0	15.5	23.1	23.9	31.8	47.1	**61.1**	**74.7**	**79.6**
in local ccy	0.0	1.0	1.0	0.9	0.7	0.9	4.7	10.9	15.5	17.0	21.9	32.5	**34.9**	**45.1**	**52.7**
in foreign ccy	0.0	2.1	2.1	2.2	2.6	2.9	4.4	4.7	7.6	5.6	8.6	12.5	**26.2**	**29.7**	**26.9**
Primary expenditures	56.0	76.4	109.9	134.0	170.9	237.7	233.4	288.0	310.3	371.8	371.6	383.0	**502.2**	**516.4**	**612.1**
Primary expenditures @2002 prices	51.5	60.0	68.9	72.5	74.2	79.9	70.6	76.1	71.3	79.1	76.4	69.6	**70.0**	**59.6**	**60.5**
Primary balance	-1.0	-6.0	-4.5	-0.5	-5.0	-6.0	-23.7	-47.4	4.3	-25.8	-32.4	-26.1	**-81.5**	**-9.0**	**-6.2**
Naftogaz, Banks, SDGF fin req.	…	…	…	…	…	…	…	…	…	…	…	…	**150.0**	**50.0**	**50.0**
Net borrowing (historical data)															
Domestic borrowing (UAHbn)		4.1	7.2	1.6	3.6	25.3	62.3	70.7	53.6	67.6	109.8	227.3	…	…	…
External borrowing (US$bn)		1.1	0.7	1.9	1.2	0.0	4.7	6.6	2.8	4.9	6.0	7.2	…	…	…
Domestic redemptions (UAHbn)		1.3	2.5	4.7	3.5	5.9	13.5	30.9	47.4	53.5	66.8	98.9	**144.1**	**133.2**	**83.5**
External redemptions (US$bn)		0.1	0.2	0.2	0.3	0.4	1.6	0.9	2.0	4.1	5.5	4.9	**6.2**	**3.3**	**4.2**
Net dom borrowings (UAHbn)		2.9	4.7	-3.1	0.1	19.4	48.8	39.8	6.2	14.2	43.0	128.4	…	…	…
Net ext borrowings (US$bn)		1.0	0.6	1.7	0.9	-0.4	3.1	5.7	0.7	0.8	0.5	2.3	…	…	…
Budget (% of GDP)															
Revenues	20.6	20.4	23.9	24.5	23.0	24.4	23.0	22.2	24.2	24.6	23.3	23.0	**22.1**	**22.1**	**22.1**
Expenditures	20.9	23.0	25.6	25.2	24.2	25.5	26.5	28.0	25.6	28.1	27.7	27.7	**29.6**	**25.7**	**25.2**
Balance	-0.4	-2.6	-1.7	-0.7	-1.2	-1.0	-3.6	-5.8	-1.4	-3.5	-4.4	-4.7	**-7.5**	**-3.6**	**-3.1**
Debt service %GDP	0.0	0.9	0.7	0.6	0.5	0.4	1.0	1.4	1.8	1.7	2.2	3.0	**3.2**	**3.3**	**2.9**
Primary balance	-0.4	-1.7	-1.0	-0.1	-0.7	-0.6	-2.6	-4.4	0.3	-1.8	-2.2	-1.7	**-4.3**	**-0.4**	**-0.2**
Primary exp @2002 prices %GDP	20.9	22.1	24.9	24.6	23.7	25.1	25.6	26.6	23.8	26.4	25.5	24.7	**26.4**	**22.5**	**22.3**
Debt service / revenues %	0.0	4.4	3.0	2.3	2.0	1.6	4.3	6.5	7.4	6.9	9.4	13.2	**14.5**	**14.7**	**13.1**
Public debt													**14.5**	**14.5**	**14.5**
Direct dom debt (UAHbn)	20.5	20.6	19.2	16.6	17.8	44.7	91.1	141.7	158.3	190.3	257.0	461.0	**753.6**	**887.3**	**1,023.0**

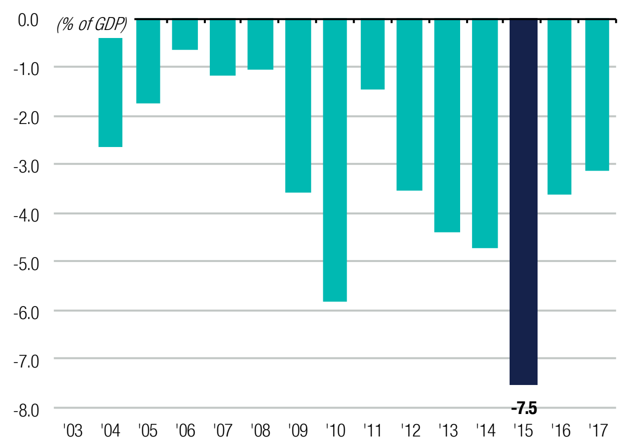
Table 23. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Direct ext debt (US$bn)	8.6	8.8	8.7	9.8	10.6	11.0	15.1	22.9	24.5	26.0	27.1	30.7	**35.0**	**25.8**	**25.8**
Guaranteed dom debt (UAHbn)	0.0	0.0	0.0	0.0	1.0	2.0	14.1	13.8	12.2	16.2	27.1	27.9	**29.9**	**31.9**	**33.9**
Guaranteed ext debt (US$bn)	2.1	3.3	3.0	2.9	3.3	7.3	9.5	12.0	13.0	12.4	9.3	8.0	**15.5**	**23.1**	**30.6**
Total (UAHbn)	77.5	85.0	78.1	80.5	88.7	189.4	301.5	432.2	469.9	515.5	584.1	1,100.6	**2,097.1**	**2,288.2**	**2,750.3**
Total debt (% of GDP)	29.0	24.6	17.7	14.8	12.3	20.0	33.0	39.9	36.1	36.6	40.1	71.0	**110.2**	**99.6**	**100.2**
Total direct (% of GDP)	24.7	19.5	14.3	12.1	9.9	13.8	23.2	29.9	27.2	28.3	33.0	61.0	**87.4**	**70.1**	**65.5**
Change															
Direct dom debt (UAHbn)		0.1	-1.4	-2.6	1.2	26.9	46.4	50.6	16.6	32.0	66.7	204.0	**292.6**	**133.7**	**135.7**
Direct ext debt (US$bn)		0.2	-0.1	1.1	0.8	0.4	4.0	7.8	1.6	1.5	1.1	3.6	**4.3**	**-9.2**	**0.0**
Guaranteed dom debt (UAHbn)		0.0	0.0	0.0	1.0	1.0	12.1	-0.2	-1.6	4.0	10.9	0.7	**2.0**	**2.0**	**2.0**
Guaranteed ext debt (US$bn)		1.2	-0.4	-0.1	0.4	4.0	2.2	2.5	1.0	-0.5	-3.1	-1.4	**7.6**	**7.6**	**7.6**
Total (UAHbn)		7.5	-6.9	2.4	8.2	100.7	112.1	130.7	37.7	45.6	68.6	516.4	**996.5**	**191.2**	**462.1**
Effective cost of public debt (%)															
Domestic		4.8	4.9	5.0	4.3	2.7	6.9	9.4	10.3	9.8	9.8	9.0	**9.0**	**9.0**	**9.0**
External		4.6	4.7	4.7	5.1	5.2	5.1	3.1	4.0	2.7	4.0	4.3	**4.3**	**4.3**	**4.3**
External balance															
FX res (US$bn)	6.9	9.5	19.4	22.3	32.5	31.5	26.5	34.6	31.8	24.5	20.4	7.5	**10.7**	**15.6**	**15.2**
Imports, goods+services (US$bn)	27.7	36.3	43.7	53.3	72.2	100.0	56.2	73.2	99.0	104.4	100.8	74.1	**61.0**	**60.4**	**64.2**
Imports cov (months)	2.3	2.6	4.4	3.7	3.9	6.7	4.3	4.2	3.7	2.9	3.3	1.5	**2.1**	**2.9**	**2.7**
Imports cov by FX res (weeks)	9.9	11.3	18.9	16.0	16.9	29.2	18.8	18.2	15.8	12.7	14.3	6.4	**9.2**	**12.6**	**11.8**

Sources: State Statistics Committee of Ukraine, Ministry of Finance of Ukraine, National Bank of Ukraine, ICU.

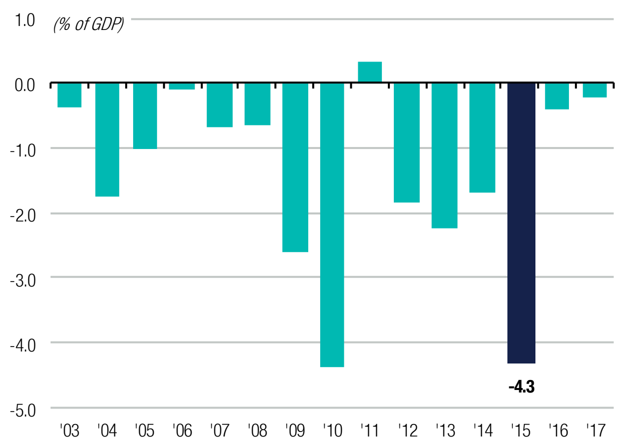
Chart 93. Budget balance of the central government(% GDP): total balance (left) and primary balance (right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

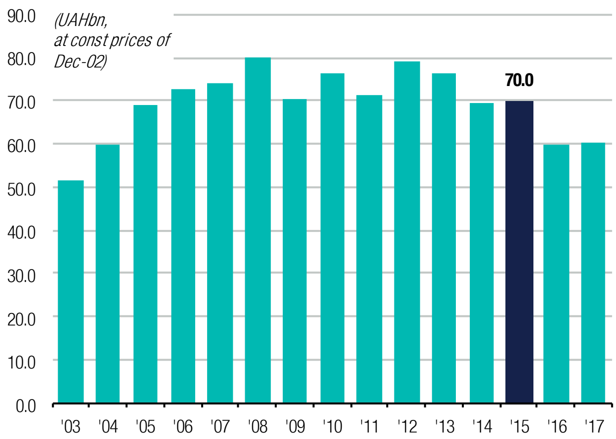
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

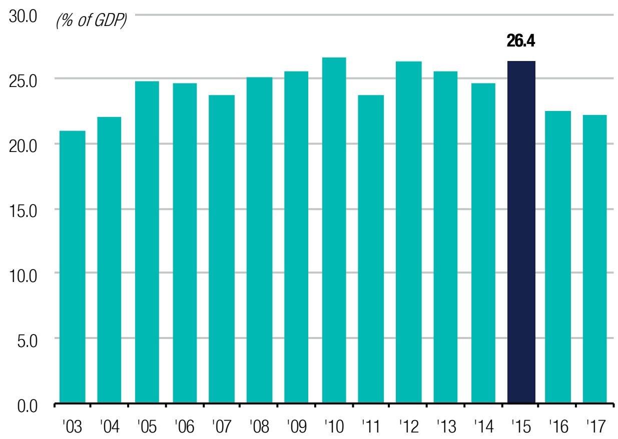
Chart 94. Budget expenditures of the central government: at constant prices of Dec-02 (UAHbn, left) and as share of GDP (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

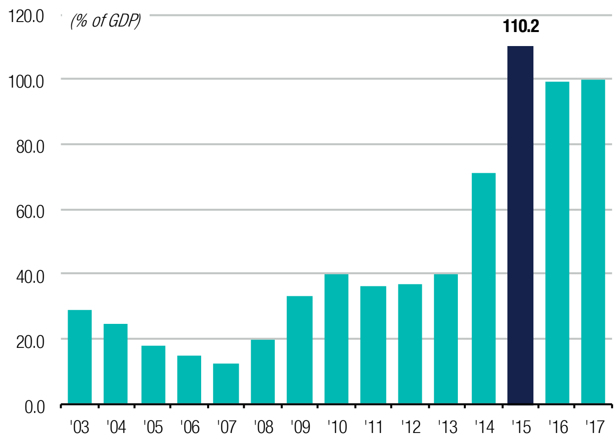
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

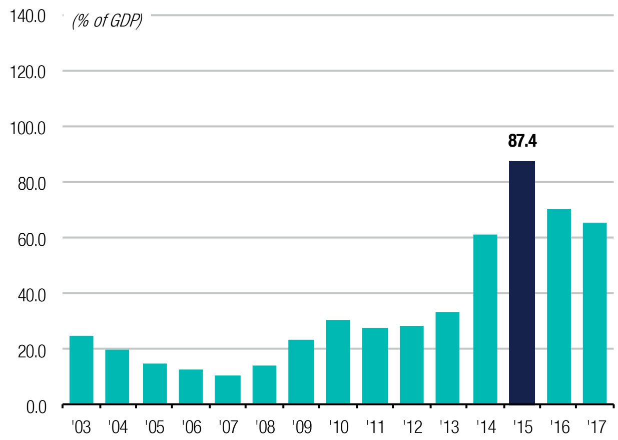
Chart 95. Public debt level as share of GDP: total debt, including direct and guaranteed debt (%, left) and direct debt (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

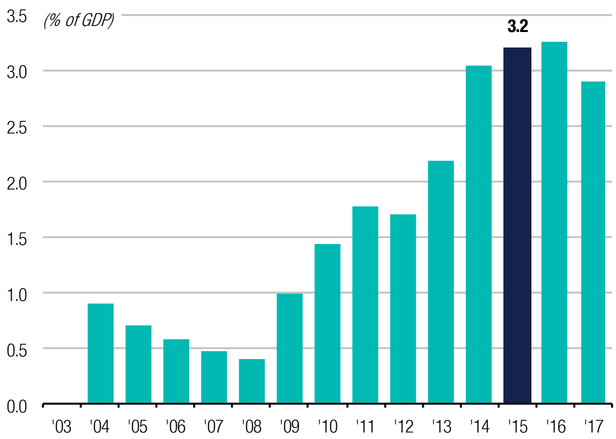
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

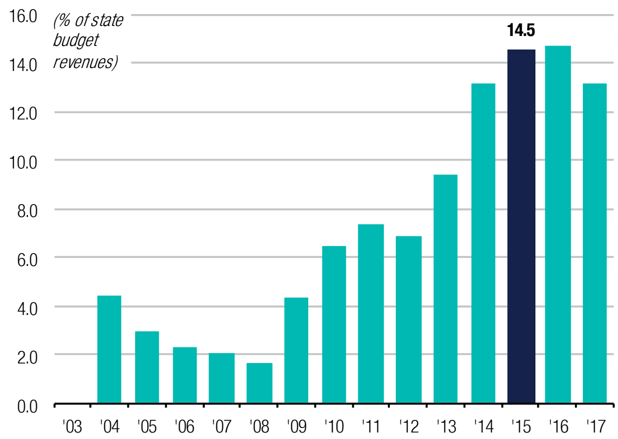
Chart 96. Debt service expenditures of the central government: as share of GDP (%, left) and as share of budget revenues (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

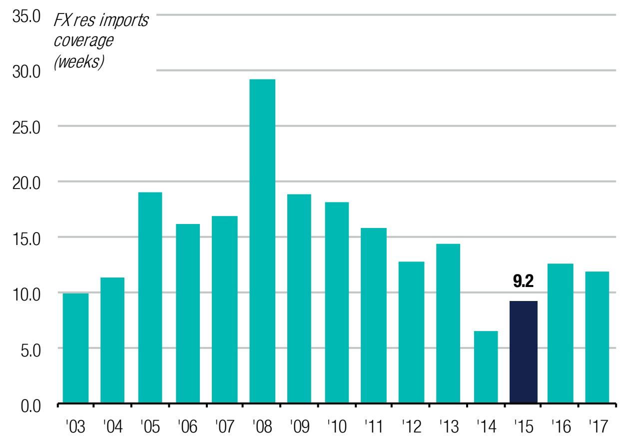
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

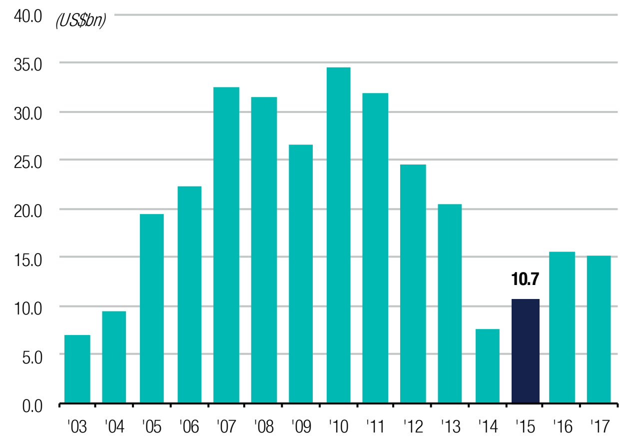
Chart 97. FX reserves: volume (US$bn, left) and ratio of imports coverage (weeks, right)

History from 2003 through 2014 and forecast for 2015-17



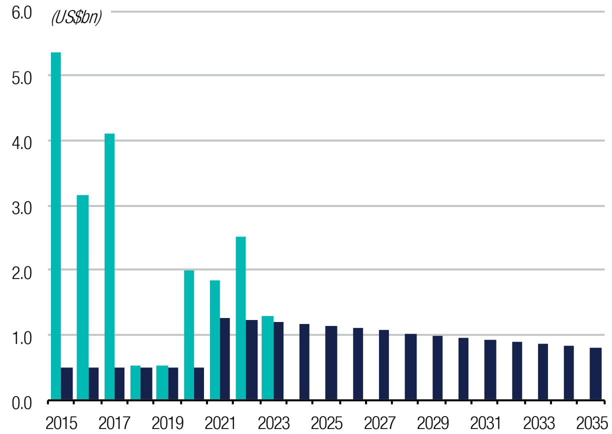
Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

History from 2003 through 2014 and forecast for 2015-17

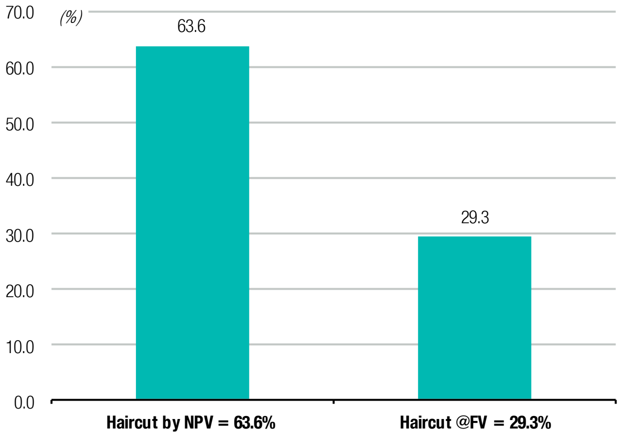


Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

Chart 98. Eurobond debt cash flow, interest and pricnicpal, before and after restructuring (US$bn, left) and NPV* of restructured debt as share of NPV of cash flow of 'old' debt and nominal value of 'old' debt (%, right)



Source: ICU.



Note: * 15% exit yield is assumed. Source: ICU.

Impact of external debt restructuring (scenario #6)

Macro: Average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH average FX rate in 2015-17 is 21.70.

External debt restructuring: Sovereign Eurobonds are restructured with total face value of US$16.2bn (this does exclude the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed **coupon rate 4.5%**; redemption starts in 2021 by 15 equal installments each US$1.08bn a year. **No principal haircut.**

Table 24. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Activity															
Real GDP % YoY	9.6	12.1	2.7	7.3	7.9	2.3	-14.8	4.1	5.2	0.2	-0.1	-6.7	**-7.6**	**0.0**	**2.6**
Nominal GDP (UAHbn)	267.3	345.1	441.5	544.2	720.7	948.1	913.3	1,082.6	1,302.1	1,408.9	1,454.9	1,551.0	**1,903.4**	**2,298.5**	**2,744.8**
Nominal GDP (US$bn)	50.1	64.9	86.9	108.2	143.3	183.9	113.7	136.3	163.0	174.2	178.3	130.1	**87.7**	**105.9**	**126.5**
Nominal GDP @2002 prices	245.7	271.2	277.0	294.4	313.1	318.7	276.2	286.1	299.1	299.6	299.3	281.7	**265.3**	**265.3**	**271.1**
Inflation															
CPI headline (%YoY, eop)	8.2	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	**25.1**	**16.4**	**14.5**
CPI headline (%YoY, average)	5.2	9.0	13.6	9.1	12.8	25.3	16.0	9.4	8.0	0.6	-0.3	12.1	**29.0**	**17.9**	**15.0**
Index GDP defl avg @2002 prices	108.8	127.3	159.4	184.8	230.2	297.5	330.6	378.3	435.4	470.2	486.1	550.6	**717.5**	**866.5**	**1,012.5**
FX rate															
US$ in UAH (eop)	5.33	5.31	5.05	5.05	5.05	7.80	8.00	7.94	8.00	8.05	8.24	15.82	**21.70**	**21.70**	**21.70**
US$ in UAH (average)	5.33	5.32	5.10	5.03	5.03	5.25	8.03	7.94	7.99	8.08	8.16	12.00	**21.70**	**21.70**	**21.70**
Budget (UAHbn)															
Revenues	55.0	70.3	105.3	133.5	165.9	231.7	209.7	240.6	314.6	346.0	339.2	357.0	**420.6**	**507.5**	**605.9**
Expenditures	56.0	79.5	113.0	137.1	174.3	241.5	242.4	303.6	333.4	395.7	403.4	430.1	**563.2**	**591.2**	**691.6**
Balance	-1.0	-9.1	-7.6	-3.6	-8.3	-9.8	-32.7	-63.0	-18.8	-49.6	-64.2	-73.2	**-142.6**	**-83.7**	**-85.7**
Debt service	0.0	3.1	3.1	3.1	3.3	3.8	9.0	15.5	23.1	23.9	31.8	47.1	**64.5**	**78.6**	**82.0**
in local ccy	0.0	1.0	1.0	0.9	0.7	0.9	4.7	10.9	15.5	17.0	21.9	32.5	**34.9**	**45.1**	**52.7**
in foreign ccy	0.0	2.1	2.1	2.2	2.6	2.9	4.4	4.7	7.6	5.6	8.6	12.5	**29.6**	**33.6**	**29.3**
Primary expenditures	56.0	76.4	109.9	134.0	170.9	237.7	233.4	288.0	310.3	371.8	371.6	383.0	**498.7**	**512.5**	**609.6**
Primary expenditures @2002 prices	51.5	60.0	68.9	72.5	74.2	79.9	70.6	76.1	71.3	79.1	76.4	69.6	**69.5**	**59.1**	**60.2**
Primary balance	-1.0	-6.0	-4.5	-0.5	-5.0	-6.0	-23.7	-47.4	4.3	-25.8	-32.4	-26.1	**-78.1**	**-5.1**	**-3.7**
Naftogaz, Banks, SDGF fin req.	…	…	…	…	…	…	…	…	…	…	…	…	**150.0**	**50.0**	**50.0**
Net borrowing (historical data)															
Domestic borrowing (UAHbn)		4.1	7.2	1.6	3.6	25.3	62.3	70.7	53.6	67.6	109.8	227.3	**…**	**…**	**…**
External borrowing (US$bn)		1.1	0.7	1.9	1.2	0.0	4.7	6.6	2.8	4.9	6.0	7.2	**…**	**…**	**…**
Domestic redemptions (UAHbn)		1.3	2.5	4.7	3.5	5.9	13.5	30.9	47.4	53.5	66.8	98.9	**144.1**	**133.2**	**83.5**
External redemptions (US$bn)		0.1	0.2	0.2	0.3	0.4	1.6	0.9	2.0	4.1	5.5	4.9	**6.2**	**3.3**	**4.2**
Net dom borrowings (UAHbn)		2.9	4.7	-3.1	0.1	19.4	48.8	39.8	6.2	14.2	43.0	128.4	**…**	**…**	**…**
Net ext borrowings (US$bn)		1.0	0.6	1.7	0.9	-0.4	3.1	5.7	0.7	0.8	0.5	2.3	**…**	**…**	**…**
Budget (% of GDP)															
Revenues	20.6	20.4	23.9	24.5	23.0	24.4	23.0	22.2	24.2	24.6	23.3	23.0	**22.1**	**22.1**	**22.1**
Expenditures	20.9	23.0	25.6	25.2	24.2	25.5	26.5	28.0	25.6	28.1	27.7	27.7	**29.6**	**25.7**	**25.2**
Balance	-0.4	-2.6	-1.7	-0.7	-1.2	-1.0	-3.6	-5.8	-1.4	-3.5	-4.4	-4.7	**-7.5**	**-3.6**	**-3.1**
Debt service %GDP	0.0	0.9	0.7	0.6	0.5	0.4	1.0	1.4	1.8	1.7	2.2	3.0	**3.4**	**3.4**	**3.0**
Primary balance	-0.4	-1.7	-1.0	-0.1	-0.7	-0.6	-2.6	-4.4	0.3	-1.8	-2.2	-1.7	**-4.1**	**-0.2**	**-0.1**
Primary exp @2002 prices %GDP	20.9	22.1	24.9	24.6	23.7	25.1	25.6	26.6	23.8	26.4	25.5	24.7	**26.2**	**22.3**	**22.2**
Debt service / revenues %	0.0	4.4	3.0	2.3	2.0	1.6	4.3	6.5	7.4	6.9	9.4	13.2	**15.3**	**15.5**	**13.5**
Public debt													**14.5**	**14.5**	**14.5**
Direct dom debt (UAHbn)	20.5	20.6	19.2	16.6	17.8	44.7	91.1	141.7	158.3	190.3	257.0	461.0	**753.6**	**887.3**	**1,023.0**
Direct ext debt (US$bn)	8.6	8.8	8.7	9.8	10.6	11.0	15.1	22.9	24.5	26.0	27.1	30.7	**39.9**	**30.7**	**30.7**

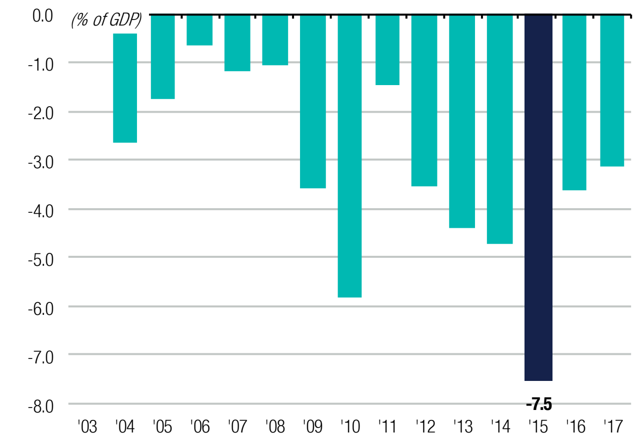
Table 24. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Guaranteed dom debt (UAHbn)	0.0	0.0	0.0	0.0	1.0	2.0	14.1	13.8	12.2	16.2	27.1	27.9	**29.9**	**31.9**	**33.9**
Guaranteed ext debt (US$bn)	2.1	3.3	3.0	2.9	3.3	7.3	9.5	12.0	13.0	12.4	9.3	8.0	**15.5**	**23.1**	**30.6**
Total (UAHbn)	77.5	85.0	78.1	80.5	88.7	189.4	301.5	432.2	469.9	515.5	584.1	1,100.6	**1,985.6**	**2,085.9**	**2,387.5**
Total debt (% of GDP)	29.0	24.6	17.7	14.8	12.3	20.0	33.0	39.9	36.1	36.6	40.1	71.0	**104.3**	**90.8**	**87.0**
Total direct (% of GDP)	24.7	19.5	14.3	12.1	9.9	13.8	23.2	29.9	27.2	28.3	33.0	61.0	**85.1**	**67.6**	**61.5**
Change															
Direct dom debt (UAHbn)		0.1	-1.4	-2.6	1.2	26.9	46.4	50.6	16.6	32.0	66.7	204.0	**292.6**	**133.7**	**135.7**
Direct ext debt (US$bn)		0.2	-0.1	1.1	0.8	0.4	4.0	7.8	1.6	1.5	1.1	3.6	**9.2**	**-9.2**	**0.0**
Guaranteed dom debt (UAHbn)		0.0	0.0	0.0	1.0	1.0	12.1	-0.2	-1.6	4.0	10.9	0.7	**2.0**	**2.0**	**2.0**
Guaranteed ext debt (US$bn)		1.2	-0.4	-0.1	0.4	4.0	2.2	2.5	1.0	-0.5	-3.1	-1.4	**7.6**	**7.6**	**7.6**
Total (UAHbn)		7.5	-6.9	2.4	8.2	100.7	112.1	130.7	37.7	45.6	68.6	516.4	**885.0**	**100.4**	**301.6**
Effective cost of public debt (%)															
Domestic		4.8	4.9	5.0	4.3	2.7	6.9	9.4	10.3	9.8	9.8	9.0	**9.0**	**9.0**	**9.0**
External		4.6	4.7	4.7	5.1	5.2	5.1	3.1	4.0	2.7	4.0	4.3	**4.3**	**4.3**	**4.3**
External balance															
FX res (US$bn)	6.9	9.5	19.4	22.3	32.5	31.5	26.5	34.6	31.8	24.5	20.4	7.5	**10.7**	**15.6**	**15.2**
Imports, goods+services (US$bn)	27.7	36.3	43.7	53.3	72.2	100.0	56.2	73.2	99.0	104.4	100.8	74.1	**61.0**	**60.4**	**64.2**
Imports cov (months)	2.3	2.6	4.4	3.7	3.9	6.7	4.3	4.2	3.7	2.9	3.3	1.5	**2.1**	**2.9**	**2.7**
Imports cov by FX res (weeks)	9.9	11.3	18.9	16.0	16.9	29.2	18.8	18.2	15.8	12.7	14.3	6.4	**9.2**	**12.6**	**11.8**

Sources: State Statistics Committee of Ukraine, Ministry of Finance of Ukraine, National Bank of Ukraine, ICU.

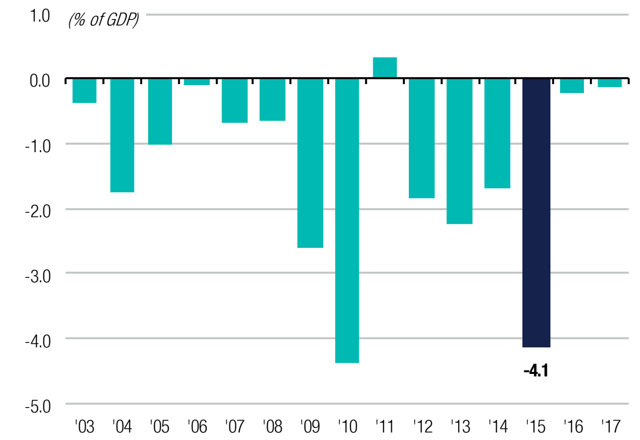
Chart 99. Budget balance of the central government(% GDP): total balance (left) and primary balance (right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

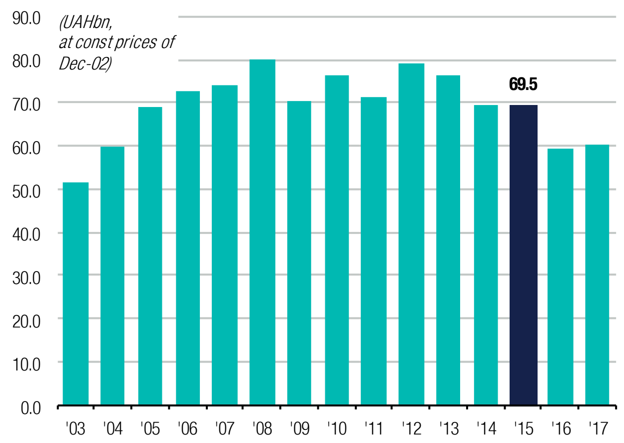
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

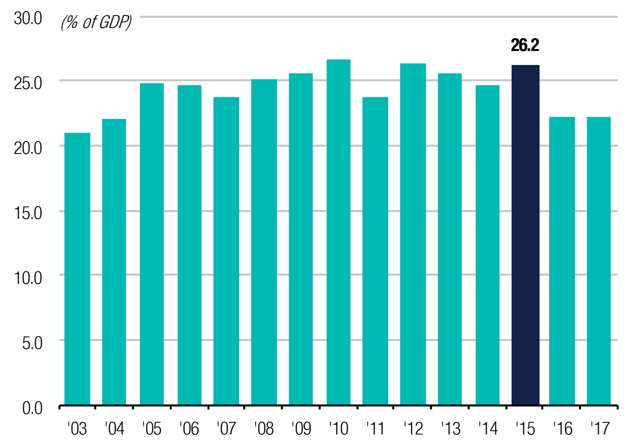
Chart 100. Budget expenditures of the central government: at constant prices of Dec-02 (UAHbn, left) and as share of GDP (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

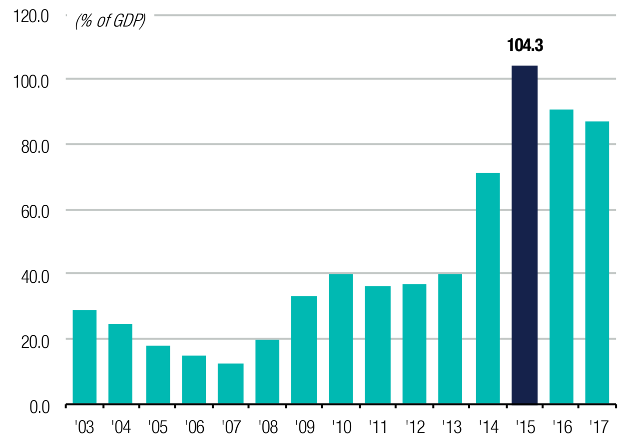
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

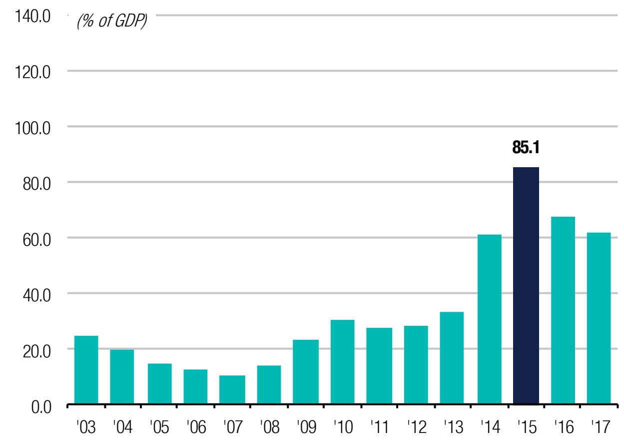
Chart 101. Public debt level as share of GDP: total debt, including direct and guaranteed debt (%, left) and direct debt (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

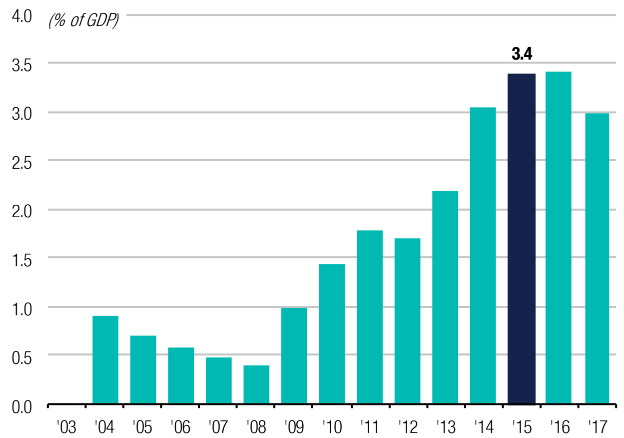
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

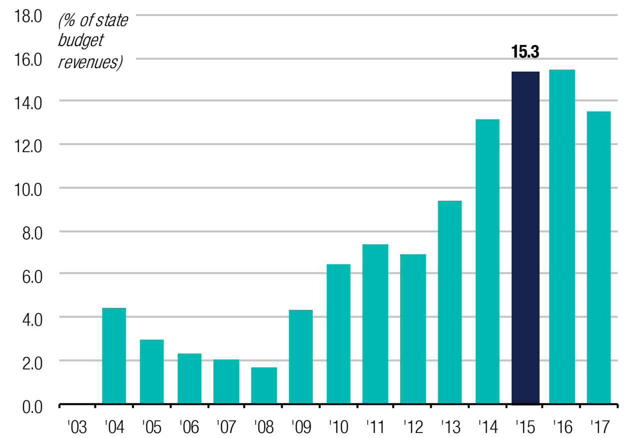
Chart 102. Debt service expenditures of the central government: as share of GDP (%, left) and as share of budget revenues (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

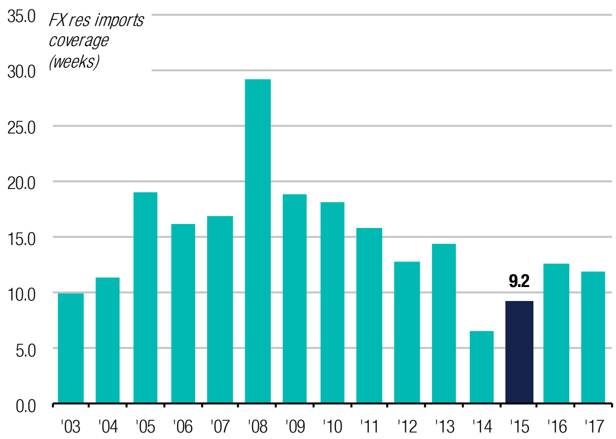
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

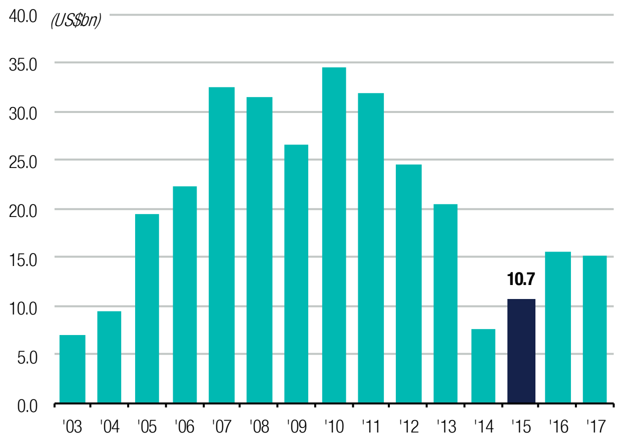
Chart 103. FX reserves: volume (US$bn, left) and ratio of imports coverage (weeks, right)

History from 2003 through 2014 and forecast for 2015-17



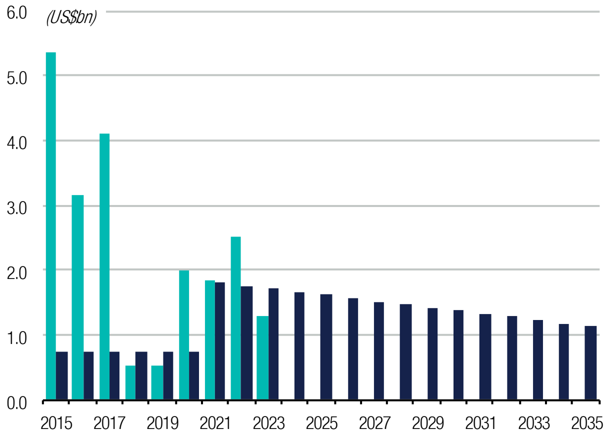
Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

History from 2003 through 2014 and forecast for 2015-17

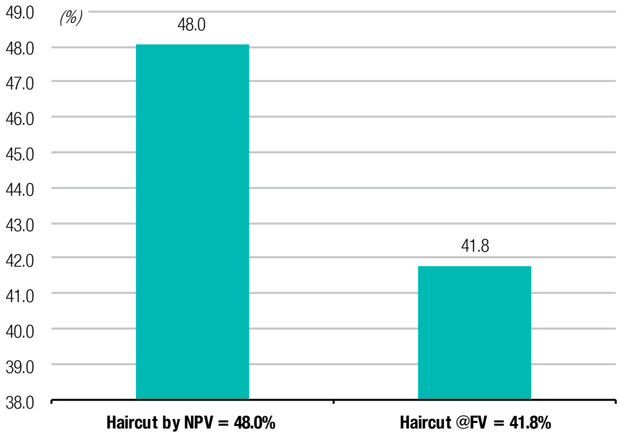


Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

Chart 104. Eurobond debt cash flow, interest and pricnicpal, before and after restructuring (US$bn, left) and NPV* of restructured debt as share of NPV of cash flow of 'old' debt and nominal value of 'old' debt (%, right)



Source: ICU.



Note: * 15% exit yield is assumed. Source: ICU.

Impact of external debt restructuring (scenario #7)

Macro: Average real GDP growth in 2015-17 is -1.8% YoY; USD/UAH average FX rate in 2015, 2016 and 2017 is 25.25, 27 and 29.75.5 respectively. See Table 8 on p.45.

External debt restructuring: Sovereign Eurobonds are restructured with total face value of US$16.2bn (this does exclude the US$1bn Eurobond backed by US government due in 2019 and does include the US$3bn Eurobond due in Dec-15). New Eurobond details: fixed **coupon rate 4.5%**; redemption starts in 2021 by 15 equal installments each US$1.08bn a year. **50% principal haircut.**

Table 25. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Activity															
Real GDP % YoY	9.6	12.1	2.7	7.3	7.9	2.3	-14.8	4.1	5.2	0.2	-0.1	-6.7	**-7.6**	**0.0**	**2.6**
Nominal GDP (UAHbn)	267.3	345.1	441.5	544.2	720.7	948.1	913.3	1,082.6	1,302.1	1,408.9	1,454.9	1,551.0	**1,903.4**	**2,298.5**	**2,744.8**
Nominal GDP (US$bn)	50.1	64.9	86.9	108.2	143.3	183.9	113.7	136.3	163.0	174.2	178.3	130.1	**75.3**	**84.9**	**92.1**
Nominal GDP @2002 prices	245.7	271.2	277.0	294.4	313.1	318.7	276.2	286.1	299.1	299.6	299.3	281.7	**265.3**	**265.3**	**271.1**
Inflation															
CPI headline (%YoY, eop)	8.2	12.3	10.3	11.6	16.6	22.3	12.3	9.1	4.6	-0.2	0.5	24.9	**25.1**	**16.4**	**14.5**
CPI headline (%YoY, average)	5.2	9.0	13.6	9.1	12.8	25.3	16.0	9.4	8.0	0.6	-0.3	12.1	**29.0**	**17.9**	**15.0**
Index GDP defl avg @2002 prices	108.8	127.3	159.4	184.8	230.2	297.5	330.6	378.3	435.4	470.2	486.1	550.6	**717.5**	**866.5**	**1,012.5**
FX rate															
US$ in UAH (eop)	5.33	5.31	5.05	5.05	5.05	7.80	8.00	7.94	8.00	8.05	8.24	15.82	**26.00**	**28.00**	**30.00**
US$ in UAH (average)	5.33	5.32	5.10	5.03	5.03	5.25	8.03	7.94	7.99	8.08	8.16	12.00	**25.25**	**27.00**	**29.75**
Budget (UAHbn)															
Revenues	55.0	70.3	105.3	133.5	165.9	231.7	209.7	240.6	314.6	346.0	339.2	357.0	**420.6**	**507.5**	**605.9**
Expenditures	56.0	79.5	113.0	137.1	174.3	241.5	242.4	303.6	333.4	395.7	403.4	430.1	**563.2**	**591.2**	**691.6**
Balance	-1.0	-9.1	-7.6	-3.6	-8.3	-9.8	-32.7	-63.0	-18.8	-49.6	-64.2	-73.2	**-142.6**	**-83.7**	**-85.7**
Debt service	0.0	3.1	3.1	3.1	3.3	3.8	9.0	15.5	23.1	23.9	31.8	47.1	**56.1**	**67.2**	**71.3**
in local ccy	0.0	1.0	1.0	0.9	0.7	0.9	4.7	10.9	15.5	17.0	21.9	32.5	**34.9**	**45.1**	**52.7**
in foreign ccy	0.0	2.1	2.1	2.2	2.6	2.9	4.4	4.7	7.6	5.6	8.6	12.5	**21.2**	**22.1**	**18.6**
Primary expenditures	56.0	76.4	109.9	134.0	170.9	237.7	233.4	288.0	310.3	371.8	371.6	383.0	**507.2**	**524.0**	**620.4**
Primary expenditures @2002 prices	51.5	60.0	68.9	72.5	74.2	79.9	70.6	76.1	71.3	79.1	76.4	69.6	**70.7**	**60.5**	**61.3**
Primary balance	-1.0	-6.0	-4.5	-0.5	-5.0	-6.0	-23.7	-47.4	4.3	-25.8	-32.4	-26.1	**-86.5**	**-16.5**	**-14.5**
Naftogaz, Banks, SDGF fin req.	…	…	…	…	…	…	…	…	…	…	…	…	**150.0**	**50.0**	**50.0**
Net borrowing (historical data)															
Domestic borrowing (UAHbn)		4.1	7.2	1.6	3.6	25.3	62.3	70.7	53.6	67.6	109.8	227.3	…	…	…
External borrowing (US$bn)		1.1	0.7	1.9	1.2	0.0	4.7	6.6	2.8	4.9	6.0	7.2	…	…	…
Domestic redemptions (UAHbn)		1.3	2.5	4.7	3.5	5.9	13.5	30.9	47.4	53.5	66.8	98.9	**144.1**	**133.2**	**83.5**
External redemptions (US$bn)		0.1	0.2	0.2	0.3	0.4	1.6	0.9	2.0	4.1	5.5	4.9	**6.2**	**3.3**	**4.2**
Net dom borrowings (UAHbn)		2.9	4.7	-3.1	0.1	19.4	48.8	39.8	6.2	14.2	43.0	128.4	…	…	…
Net ext borrowings (US$bn)		1.0	0.6	1.7	0.9	-0.4	3.1	5.7	0.7	0.8	0.5	2.3	…	…	…
Budget (% of GDP)															
Revenues	20.6	20.4	23.9	24.5	23.0	24.4	23.0	22.2	24.2	24.6	23.3	23.0	**22.1**	**22.1**	**22.1**
Expenditures	20.9	23.0	25.6	25.2	24.2	25.5	26.5	28.0	25.6	28.1	27.7	27.7	**29.6**	**25.7**	**25.2**
Balance	-0.4	-2.6	-1.7	-0.7	-1.2	-1.0	-3.6	-5.8	-1.4	-3.5	-4.4	-4.7	**-7.5**	**-3.6**	**-3.1**
Debt service %GDP	0.0	0.9	0.7	0.6	0.5	0.4	1.0	1.4	1.8	1.7	2.2	3.0	**2.9**	**2.9**	**2.6**
Primary balance	-0.4	-1.7	-1.0	-0.1	-0.7	-0.6	-2.6	-4.4	0.3	-1.8	-2.2	-1.7	**-4.5**	**-0.7**	**-0.5**
Primary exp @2002 prices %GDP	20.9	22.1	24.9	24.6	23.7	25.1	25.6	26.6	23.8	26.4	25.5	24.7	**26.6**	**22.8**	**22.6**
Debt service / revenues %	0.0	4.4	3.0	2.3	2.0	1.6	4.3	6.5	7.4	6.9	9.4	13.2	**13.3**	**13.2**	**11.8**
Public debt															
Direct dom debt (UAHbn)	20.5	20.6	19.2	16.6	17.8	44.7	91.1	141.7	158.3	190.3	257.0	461.0	**753.6**	**887.3**	**1,023.0**

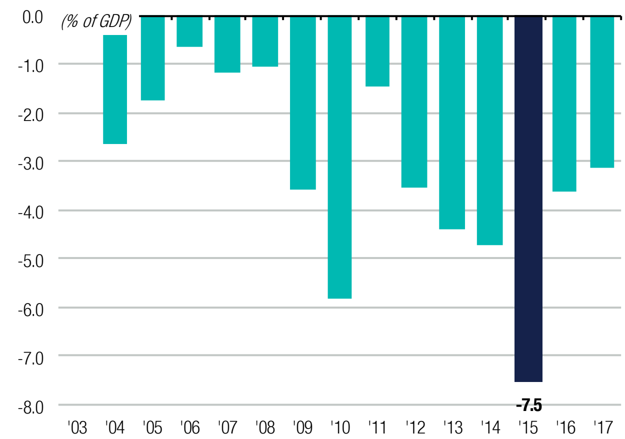
Table 25. Macroeconomic and public finances forecast for 2015-17

	History												Forecast		
	2003	**2004**	**2005**	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017**
Direct ext debt (US$bn)	8.6	8.8	8.7	9.8	10.6	11.0	15.1	22.9	24.5	26.0	27.1	30.7	**31.8**	**22.6**	**22.6**
Guaranteed dom debt (UAHbn)	0.0	0.0	0.0	0.0	1.0	2.0	14.1	13.8	12.2	16.2	27.1	27.9	**29.9**	**31.9**	**33.9**
Guaranteed ext debt (US$bn)	2.1	3.3	3.0	2.9	3.3	7.3	9.5	12.0	13.0	12.4	9.3	8.0	**15.5**	**23.1**	**30.6**
Total (UAHbn)	77.5	85.0	78.1	80.5	88.7	189.4	301.5	432.2	469.9	515.5	584.1	1,100.6	**2,012.6**	**2,197.3**	**2,652.8**
Total debt (% of GDP)	29.0	24.6	17.7	14.8	12.3	20.0	33.0	39.9	36.1	36.6	40.1	71.0	**105.7**	**95.6**	**96.6**
Total direct (% of GDP)	24.7	19.5	14.3	12.1	9.9	13.8	23.2	29.9	27.2	28.3	33.0	61.0	**83.0**	**66.1**	**62.0**
Change															
Direct dom debt (UAHbn)		0.1	-1.4	-2.6	1.2	26.9	46.4	50.6	16.6	32.0	66.7	204.0	**292.6**	**133.7**	**135.7**
Direct ext debt (US$bn)		0.2	-0.1	1.1	0.8	0.4	4.0	7.8	1.6	1.5	1.1	3.6	**1.1**	**-9.2**	**0.0**
Guaranteed dom debt (UAHbn)		0.0	0.0	0.0	1.0	1.0	12.1	-0.2	-1.6	4.0	10.9	0.7	**2.0**	**2.0**	**2.0**
Guaranteed ext debt (US$bn)		1.2	-0.4	-0.1	0.4	4.0	2.2	2.5	1.0	-0.5	-3.1	-1.4	**7.6**	**7.6**	**7.6**
Total (UAHbn)		7.5	-6.9	2.4	8.2	100.7	112.1	130.7	37.7	45.6	68.6	516.4	**912.0**	**184.7**	**455.6**
Effective cost of public debt (%)															
Domestic		4.8	4.9	5.0	4.3	2.7	6.9	9.4	10.3	9.8	9.8	9.0	**9.0**	**9.0**	**9.0**
External		4.6	4.7	4.7	5.1	5.2	5.1	3.1	4.0	2.7	4.0	4.3	**4.3**	**4.3**	**4.3**
External balance															
FX res (US$bn)	6.9	9.5	19.4	22.3	32.5	31.5	26.5	34.6	31.8	24.5	20.4	7.5	**10.7**	**15.6**	**15.2**
Imports, goods+services (US$bn)	27.7	36.3	43.7	53.3	72.2	100.0	56.2	73.2	99.0	104.4	100.8	74.1	**61.0**	**60.4**	**64.2**
Imports cov (months)	2.3	2.6	4.4	3.7	3.9	6.7	4.3	4.2	3.7	2.9	3.3	1.5	**2.1**	**2.9**	**2.7**
Imports cov by FX res (weeks)	9.9	11.3	18.9	16.0	16.9	29.2	18.8	18.2	15.8	12.7	14.3	6.4	**9.2**	**12.6**	**11.8**

Sources: State Statistics Committee of Ukraine, Ministry of Finance of Ukraine, National Bank of Ukraine, ICU.

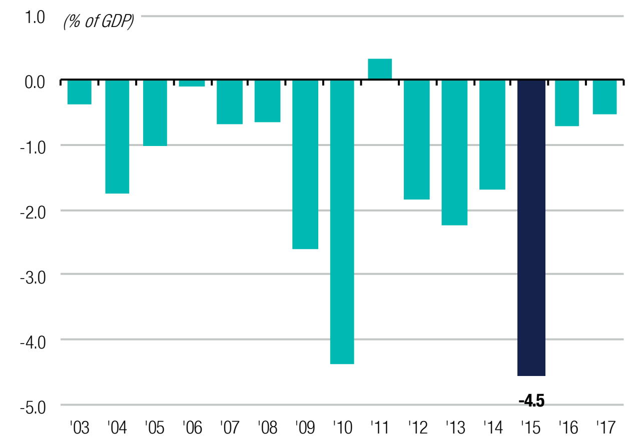
Chart 105. Budget balance of the central government(% GDP): total balance (left) and primary balance (right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

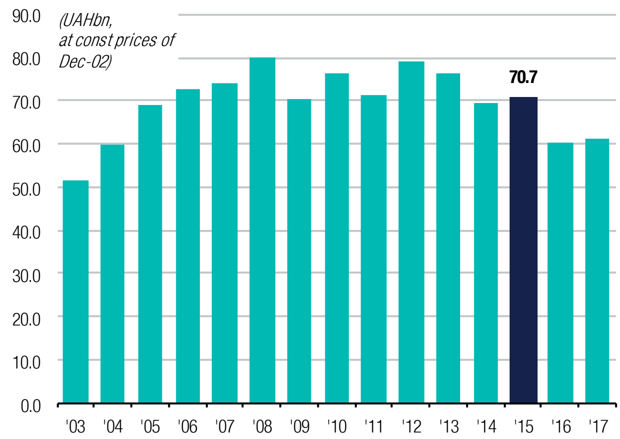
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

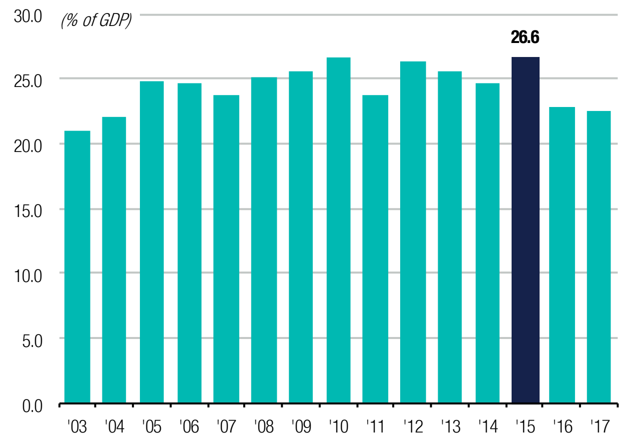
Chart 106. Budget expenditures of the central government: at constant prices of Dec-02 (UAHbn, left) and as share of GDP (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

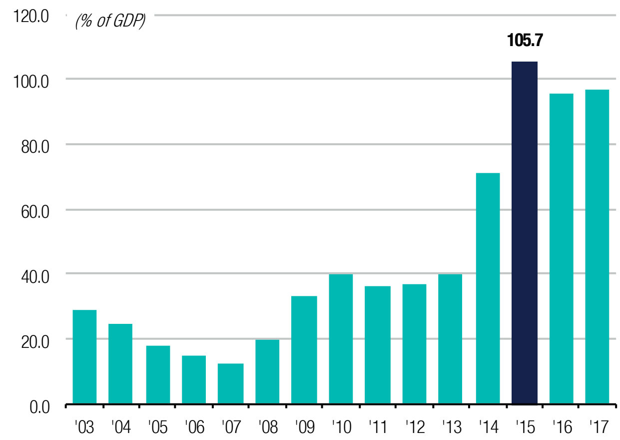
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

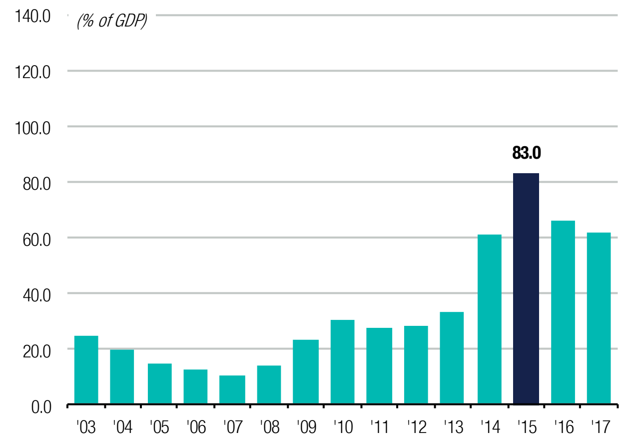
Chart 107. Public debt level as share of GDP: total debt, including direct and guaranteed debt (%, left) and direct debt (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

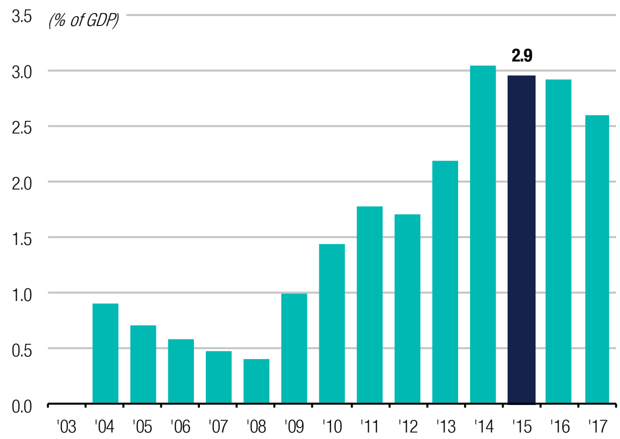
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

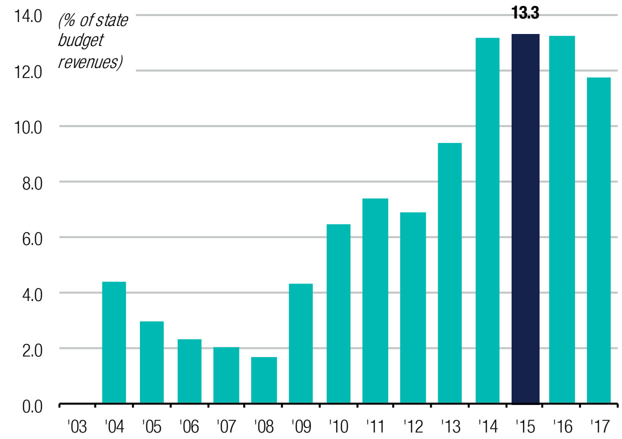
Chart 108. Debt service expenditures of the central government: as share of GDP (%, left) and as share of budget revenues (%, right)

History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

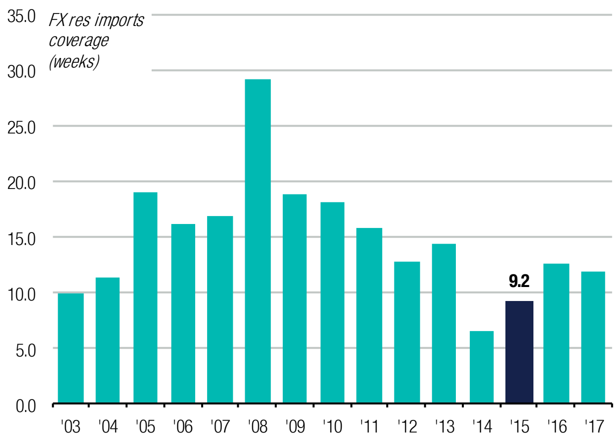
History from 2003 through 2014 and forecast for 2015-17



Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

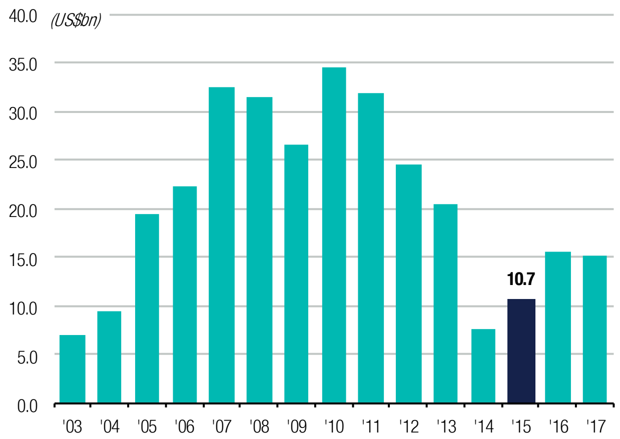
Chart 109. FX reserves: volume (US$bn, left) and ratio of imports coverage (weeks, right)

History from 2003 through 2014 and forecast for 2015-17



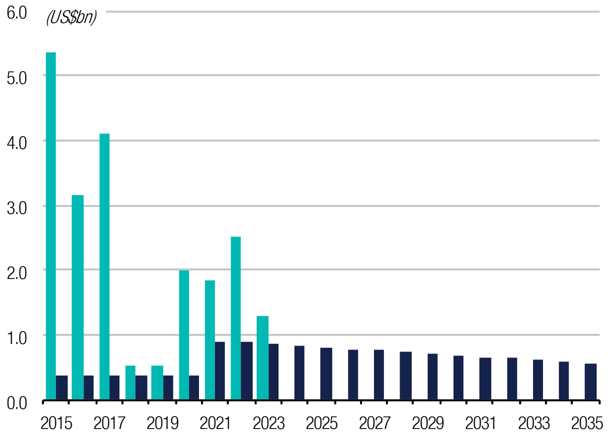
Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

History from 2003 through 2014 and forecast for 2015-17

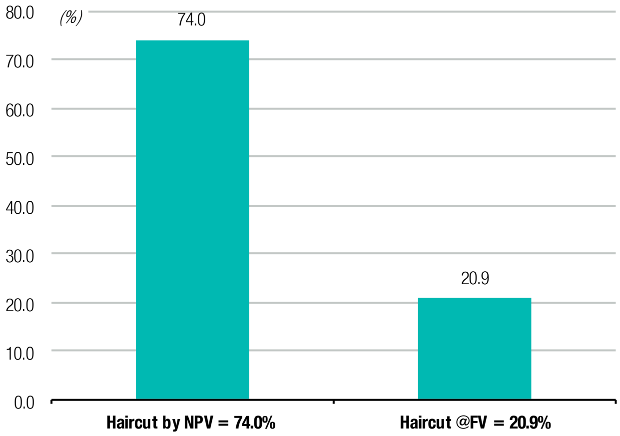


Source: Ministry of Finance of Ukraine, State Statistics Committee of Ukraine, ICU.

Chart 110. Eurobond debt cash flow, interest and pricnicpal, before and after restructuring (US$bn, left) and NPV* of restructured debt as share of NPV of cash flow of 'old' debt and nominal value of 'old' debt (%, right)



Source: ICU.



Note: * 15% exit yield is assumed. Source: ICU.

Disclosures

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This research publication has been prepared by the analyst(s), whose name(s) appear on the front page of this publication. The analyst(s) hereby certifies that the views expressed within this publication accurately reflect her/his own views about the subject financial instruments or issuers and no part of her/his compensation was, is, or will be directly or indirectly related to the inclusion of specific recommendations or views within this research publication.

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Buy: Forecasted 12-month total return greater than 20%

Hold: Forecasted 12-month total return 0% to 20%

Sell: Forecasted 12-month total return less than 0%

Note: total return is share price appreciation to a target price in relative terms plus forecasted dividend yield.

DEBT RATING DEFINITIONS

Buy: Forecasted 12-month total return significantly greater than that of relevant benchmark

Hold: Forecasted 12-month total return is in line with or modestly deviates from relevant benchmark

Sell: Forecasted 12-month total return significantly less than that of relevant benchmark

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