



INVESTMENT CAPITAL UKRAINE  
INVESTMENT BANKING

Focus  
**Ukraine**

Scope  
**Economics**

# Quarterly Report

## **Stretched, but holding up**



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PLEASE READ THE DISCLOSURES SECTION FIRST FOR IMPORTANT  
DISCLOSURES AND ANALYST CERTIFICATION



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# Executive summary

Our current revision of our April macroeconomic forecast for the 2012-14 period yields the following viewpoints:

**Global economy conditions and outlook revised downward.** The global economy has still been adjusting after the economic and financial crisis of 2007-08 sent it reeling. While post-crisis adjustments did take place in small economies like the Baltics and others, the current adjustment underway in the Eurozone, due to the region's economic size, institutional make-up and, national perceptions on the necessary changes, are proving to be messy, lengthy, and having a negative impact on key trading partners. This is why the Eurozone debt crisis has spread negative investor sentiment to other economies. Our macroeconomic forecast on Ukraine is based upon global indicators that have been revised lower, like world economic growth and Russia's economic growth, as well as crude oil, at less than US\$100/bbl, and steel prices that are projected to move in a downward trajectory over the next 12-month period, followed by a period of gradual recovery.

**Ukraine's economy has been flirting with recession.** The available statistics for 1H12 showed that Ukraine's economy was on the edge of falling into a double-dip recession. However, after a 0.3% QoQ<sup>1</sup> contraction in 1Q12, the economy grew by an estimated 0.8% QoQ, thanks to the positive impact of Euro-2012 on construction and retail trade. Other sectors like industry and transport are indeed slowly contracting, hinting that these sizably export-dependent sectors are feeling the brunt of a global slowdown. Prospects for the agriculture sector lean towards underperformance in comparison with the previous season of record-high harvest. All in all, the domestic economy is likely to drag its feet over 2H12, as it is still flirting with recession. In 2012, real GDP growth was revised downward to 1.9% YoY. An acceleration in growth is to follow in 2013 and 2014, of 3.1% and 4.0%, respectively.

**Fiscal and external balances of Ukraine's economy.** Lower growth projections for Ukraine's economy should lead to wider fiscal deficits that rose into the range of 1.1-1.6ppt in the 2012-13 period. Hence, the public debt level as measured by the debt-to-DGP ratio is going to start growing, as the state budget is expected to be run with the primary balance in deficit, i.e., towards the 40-45% level over the forecasted period, assuming that authorities avoid sizable currency devaluation but allow gradual flexibility. Due to the negative trajectory between prices in Ukraine's two main trade sectors—steel prices on the exports side, and natural gas prices on the imports side—the current account deficit projection for 2012 was revised to an increase of 0.5ppt, from 4.9% of GDP as of our estimates this April to 5.4% of GDP as of July. However, there is a silver lining in our current revision of macro forecasts. In 2013, the current account deficit is projected to contract to 2.4% of GDP (back in April, the 2013 C/A deficit forecast was 3.1%), thanks to expectations for a lower crude oil price than was seen previously.

**Hryvnia.** The exchange rate of the UAH versus the USD is expected to be guarded by the NBU's interventionist approach to FX policy. This said, however, the hryvnia's flexibility is being allowed in a measured and gradual manner. While pursuing this approach on the UAH, authorities are expected to allow an FX reserves reduction as sovereign external debt

<sup>1</sup> QoQ stands for quarter-on-quarter growth in seasonally adjusted terms.

owed to IMF is gradually paid back. We retain our April's forecast that this year's BoP shortage is to amount to more than US\$6bn, and will be covered by the use of FX reserves. Next year, in 2013, IMF lending to Ukraine is expected to resume, allowing for a BoP shortage of US\$1.5bn. In the year 2014, which precedes presidential elections, Ukraine's authorities will find it harder to adhere to the IMF programme; hence, it may be shelved again. The UAH's exchange rate, currently bearing a negative bias from market players, is set to weaken, as flexibility is gradually being apportioned by the authorities; hence, we forecast the UAH to be at 8.30/USD at year-end 2012, and then at 8.50/USD at year-end 2013.

# Politics & geopolitics

In our view, after this fall's parliamentary elections, the political *status quo* in Ukraine will be renewed. Ruling incumbents are also expected to re-establish their presence in the legislature, allowing President Yanukovich to govern with more ease over the next two years, leading up to presidential elections in early 2015. Our base-case scenario envisages a new government to be installed, albeit with familiar faces. This change will represent a sort of bid to heal relations with the West and engender better access to lenders there, and hence less costly funding).

## Run-up to elections this October

*Our basic model for October's elections still indicates a comfort zone for the ruling incumbent parties*

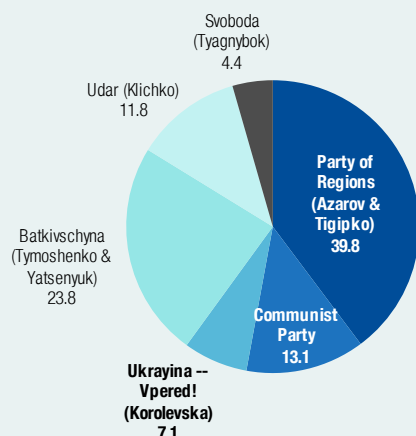
An update<sup>2</sup> to our model on the parliamentary elections, which we introduced in our spring *Quarterly Report*: "Pinned again?"<sup>3</sup>, to assess the most likely outcome, confirms our previous call made back in April that the ruling incumbents are poised to retain their hold on the parliamentary majority.

While previously, our model showed 274 MPs for the incumbents, now it foresees a 270-strong majority on the back of a recent shifts in voters' sentiment. Indeed, sentiment has been evolving, and there are, in our view, some key factors behind this shift.

First, there was an upward trend in the number of undecided voters, as their share rose to 27.2%, according to the poll carried out at the end of May, while nearly a year ago, this share stood at 17.4%. Second, individual rankings of the parties have seemingly touched the bottom of an apparent resistance level.

**Chart 1. Breakdown of parliament after elections in October**

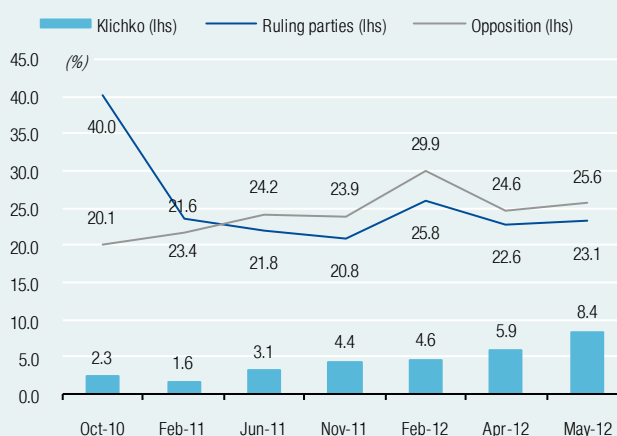
100% = 450 MPs.



Note: parties that are perceived as ruling ones after the October elections are in bold.  
Source: Investment Capital Ukraine LLC.

**Chart 2. Evolution of public approval rating: Ruling parties versus opposition**

Based on opinion polls made by Kiev International Institute for Sociology (KIIS)



Note: Ruling parties are Party of Regions, Strong Ukraine led by Mr Tigipko, Communist Party and "Ukrayina -- Vpered" led by Ms Korolevska; opposition parties are Batkivschyna led by Ms Tymoshenko and Mr Yatsenyuk, "Udar" led by Mr Klichko and "Svoboda" led by Mr Tyagnybok.  
Sources: KIIS, Investment Capital Ukraine LLC.

<sup>2</sup> See appendix section, entitled "Ukraine's political map after October 2012 (update)" on page 22.

<sup>3</sup> Published in April 2012.

***Political marriages have proven to be a failure in terms of consolidating voters***

Third, it appears that the strategy used by political unions does not pay off. This is evidenced by the fact that two alliances (the Party of Regions, with Serhiy Tigipko's "Strong Ukraine," and Yulia Tymoshenko's Batkivschyna party with Arseniy Yatsenyuk's "Front Zmin") did not gain in the opinion polls. For instance, before their political union, Ms Tymoshenko's and Mr Yatsenyuk's parties enjoyed 14.0% and 7.9%, respectively, in the February 2012 poll by Kiev International Institute for Sociology (KIIS). After declaring a joint effort for gaining as many seats in the legislature as possible this October, their total support base was measured at 15.9% in the April poll and at 14.4% in May's. The same holds true for the recent political marriage of the Party of Regions with Mr Tigipko's party, "Strong Ukraine," and it appears that this political tactic has paid off, at least for the time being.

***Independent political newcomers are causing a stir***

Fourth, there is an obvious shift toward a kind of renewal of the *status quo* political establishment in Ukraine. The political party "Udar" (which stands for "punch" in Ukrainian) of the 40-year-old practicing heavyweight boxer Vitaly Klichko personifies this shift. It has turned out that in the absence of independent political formation led by a representative of new-generation moderate politicians (under 40 years old)—the result of Mr Yatsenyuk's decision to join forces with Ms Tymoshenko's party—voters started to flow toward the support base of Mr Klichko's Udar. The latter decided to stay non-affiliated and take part in the October elections as an independent force. As a result, Klichko has nearly doubled its party's public approval rating over the past year, from a position of political obscurity to the position of political challenger, with a solid chance of beating the Communist Party by popular vote (see Chart 2 above and Table 5 on page 26).

It was probably not a coincidence that Mr Klichko is now trying to repeat his success via a political project called "Ukraina – Vpered!" (stands for the Ukrainian football-related slogan, "Go ahead, Ukraine!"), led by 37-year-old Natalya Korolevska, an ex-member of Ms Tymoshenko's faction in the parliament. An intensive prime-time TV advertisement campaign launched just recently by this party prompted allegations that the party has backing from the ruling incumbents. That is why we consider this party as future member of a kind of unofficial coalition between Party of Regions and Communist Party, if it gets through the 5% threshold.

## **Future government**

***Our view on local politics yields three scenarios as for the next government leadership***

In our view, after having entered a kind of political isolation due to the controversial jailing of former PM Yulia Tymoshenko, earning the country a "dictatorship" tag from German chancellor Angela Merkel, Ukraine President Yanukovych has an uphill task to fix this somewhat humiliating, external view on the economy. As most of the decisive decision-making over the economy was extended until the end of elections, all the planned reshuffling in Mr Yanukovych's government is likely to take place at the end of this year, taking into account the political shape of the new parliament. In our view, therefore, we present the following likely scenarios:

- 1) **Worst case: Status-quo maintained (40% probability).** The government, currently led by PM Azarov, is reinstated. The current government has a positive track record, as it restored the primary balance of the state budget (see Chart 9, pp.15); however, leaving the government intact would mean that such a decision will deprive the economy of positive momentum going forward, which could have been developed if new blood and fresh minds had been introduced.

*Our base-case scenario envisages slight make-over changes in the government*

- 2) **Base case: New PM installed (50% probability).** If the election results end according to our expectations (with ruling incumbent parties retaining their majority), then it is quite likely that Mr Yanukovych would decide to infuse some “new blood” into the government by installing 52-year-old Serhiy Tigipko, who is currently deputy prime minister. Most of the current ministers would retain their posts, including such market-friendly names as First Deputy Prime Minister Valeriy Khoroshkovsky (43 years old) and Economy Minister Petro Poroshenko (47) among others, e.g., Finance Minister Yuriy Kolobov (39).
- 3) **Best case: “New generation” (10% probability).** This is a best-case scenario, under which an under-50-year old will be installed as the PM. This could be either Valeriy Khoroshkovsky or Petro Poroshenko, who could regard themselves as modernisers and liberals, if compared to the previous ranks of PMs.

## Geopolitics: “Soft” isolation to the West and East

*Ukraine’s government is becoming more isolated from the West, and facing ever more demanding talks in the East, notably, with Russia*

At this moment in time, Ukraine’s authorities have, in all fairness, gotten into a kind of soft isolation on both sides of its geopolitical map—on the West as well as on the East, for which there are reasons. To the West, there seems to be less enthusiasm for Ukraine’s president, as the country’s democratic standards have plunged, and both domestic and foreign accusations of selective justice (in the case of former PM Tymoshenko) are rampant. To the East, where Russia is a dominant player, Ukraine’s leadership is being received in the capital, Moscow; however, these meetings have chilly undertones, as well.

Under all of the above-mentioned scenarios for the future government, we assume President Yanukovych would seek to restore cooperation with the IMF as soon as mid-4Q12 (right after the elections), for the sake of: 1) regaining credit from private lenders; and 2) gradually repaying its debt to the IMF, as well as moving away from its dependency on the Fund in terms of economic policymaking. This move will also serve as a kind of a bid to unlock Ukraine’s economic isolation from the West as private lenders in the Eurobond market who regard the country’s sovereign credit as highly risky.

By installing an individual with a more fresh perspective for the post of PM in the government (as our base- and best-case scenarios assume), Ukraine’s leadership may restart a dialogue with the Western leaders, in an attempt to fix its marred image.

It is much more complicated in the East, where the Kremlin is seeking more tangible concessions such as allowing Gazprom into the ownership of natural gas pipeline system, and participation of Ukraine in the Kremlin-led, pan-Eurasian customs union. Both issues are hard to swallow for the current Ukraine leadership, as it would be hugely unpopular politically, and quite an inconvenient development for the private sector of Ukraine that is dominated by large business groups, who do not wish to allow in foreign competitors backed by formidable sovereigns.

*For Ukraine’s leadership, it would be an arduous task to heal relations with the West*

Ultimately, it will be quite difficult for President Yanukovych to soften the West’s scepticism. This fall, parliamentary elections may represent a hurdle for this endeavour if, for instance, official results differ from exit polls. The current, uneasy relations between incumbent ruling parties and those in opposition hint that this fall, elections are not going to go off as easily as some would hope. In the East, there is the opposite attitude with regard to the domestic political issues. The Kremlin is striving to bring Ukraine’s economy under its own economic and political terms and umbrella. For it, Ukraine encountering deeper isolation from the West would be a more welcome development as it would open up more opportunity for



trade-offs with a government in Kiev that presides over an economy dependent on external financing.

***However, we expect that  
the prospect of better  
access to lenders in the  
West will be left open***

This said, we expect that Ukraine's economy will at best start next year slightly better prepared to talk to its traditional lenders in the West, the IMF and Eurobond market investors.

# Global economy

Global economic growth is stagnating, and some parts of the world are in a double-dip recession or else in a depression. Hence, global indicators for the upcoming period under our forecast, which is 2H12 and 2013-14, have been revised downward to reflect the deteriorated macroeconomic environment. Such a revision, however, may turn out to still have, in a few months or even weeks from now, a bias toward optimism. This is quite possible, as the current macro environment tends to evolve in a highly dynamic way.

## Indicators vital to Ukraine's economy

### Global economic growth

*Global growth has been constantly below expectations; ...*

Our main global growth indicators, which are the world economic output and pace of economic expansion in Russia, originate from the IMF's semi-annually updated fundamental view on global economic developments and *ad hoc* revisions to this view. The latest such updated view was made public on 16 July<sup>4</sup>. Our previous report, published in April, while totally accepting the IMF's view on the global economy, contained a more optimistic view on the Russian economy; at that point, we argued that the conditions in the commodities market (due to geopolitical risk), with a crude oil price well above the US\$100 threshold, would benefit Russia's economic growth, and we used a higher real GDP forecast than the IMF was then advocating in its outlook.

*... hence, we revised downward our current view on key global indicators compared to April's forecast*

Now, our assumptions are broadly aligned with the IMF's, as we agree with the concept that the global economy will grow at a rate this year that is well below expectations, and hence disappointing investors. Thus, we lowered our forecast on Russia's real GDP growth for 2012-14 in the range of 0.2-0.9ppt across the forecast period (see Table 1 next page). The geopolitical risks over Iran's nuclear programme are now being nearly totally counterweighted by the risks of economic stagnation, and some regions of double-dip recessions—as the epicentre of economic turmoil has shifted towards the Eurozone's highly indebted and recession-laden economies—are struggling, undergoing socially and politically harmful internal devaluations. While the trend of stagnation was smoothly and swiftly weathered by the smaller Baltic countries, which were keen to align themselves with possible future full memberships in the European Monetary Union, the opposite was happening in larger economies of the "olde" EU countries, where the solutions are more complicated without the dreaded phenomenon of internal devaluation, which looks imminent for these countries going forward. The Eurozone has a great effect on the global economy, and it is Russia's key trading partner. Hence, those global macro indicators that vital for Ukraine have been revised downward due to acute economic developments in the Eurozone, in which recession, and in some places depression, have been taking place.

<sup>4</sup> See World Economic Outlook Update "New Setbacks, Further Policy Action Needed".

Link: <http://www.imf.org/external/pubs/ft/weo/2012/update/02/index.htm>

## Crude oil

**Due to the weaker global economy, future crude oil prices are seen to be softer than we had forecast back in April, i.e., WTI crude is forecast at lower than US\$100/bbl**

Contrary to our previous macro prognosis in April, our current one has crude oil price (in terms of TWI crude) projections of lower than the US\$100/bbl threshold. Then, in the wake of the turbulent 1Q12, geopolitical risks were running high, and hence WTI crude oil projections were quite bullish, as for net exporters of crude oil, as the full-year price was seen at a hair above US\$108/bbl for 2012 on average, followed by US\$101/bbl on average for 2013, and only in 2014 was it seen below the \$100 mark, at US\$95/bbl. Today, our forecast envisages widespread concern that 1H12's economic performance was much weaker than expected. Notwithstanding geopolitical risks—which have still been lingering high, as the triangle of Iran, Israel, and the US is involved in a merciless confrontation over Iran's nuclear ambitions—world economic conditions spell out prime conditions for the crude oil market supply and demand balance, in which the latter (a weak world economy) counterweights the former (geopolitics over Iran).

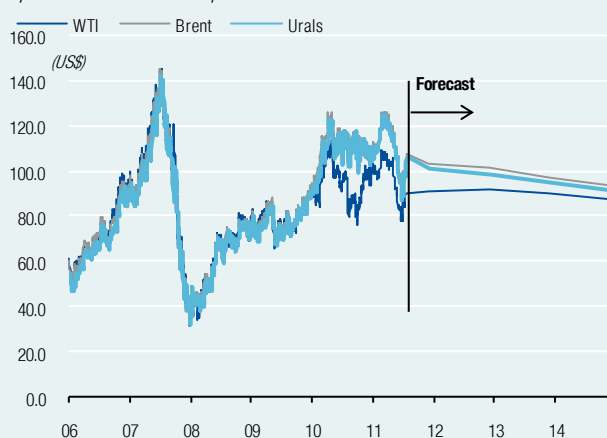
## Steel

**The steel price forecast mirrors widespread expectations of weaker demand, so they, too, were revised downward**

The steel market has been quite sensitive to the global economic signs of weak growth prospects, which were discussed above in the "Crude oil" subsection. As Chart 4 shows, steel billet futures at the LME<sup>5</sup> are pointing to a quite noticeable decline in prices, to US\$400 a tonne in a 3-month period from now, and then a gradual recovery until year-end 2013, towards US\$474 a tonne. The same trajectory of future price movement is foreseen for hot-rolled coils, which is a kind of benchmark for Ukraine's steel exports: these are forecast to reach a bottom of US\$484/tonne in 4Q12, and recover over the course of 2013 to US\$548/tonne.

**Chart 3. Crude oil price (US\$ per barrel)**

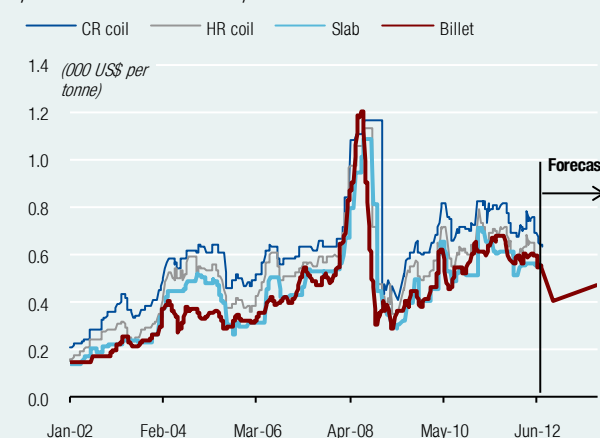
Spot and futures markets quotations



Sources: Bloomberg, Investment Capital Ukraine LLC.

**Chart 4. Steel prices (US\$ 000s per tonne)**

Spot and LME futures market quotations



Sources: Bloomberg, Investment Capital Ukraine LLC.

**Table 1. ICU's 3-year quarterly and yearly forecast for the global economy's key indicators that are vital to Ukraine's economy**

According to our base-case scenario

| Indicator                      | Quarterly forecast |        |        |        |        |        |        |        |        |        |        |        |        | Annual forecast <sup>4</sup> |        |        |        |
|--------------------------------|--------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|------------------------------|--------|--------|--------|
|                                | 4Q11               | 1Q12   | 2Q12E  | 3Q12F  | 4Q12F  | 1Q13F  | 2Q13F  | 3Q13F  | 4Q13F  | 1Q14F  | 2Q14F  | 3Q14F  | 4Q14F  | 2011                         | 2012F  | 2013F  | 2014F  |
| World real GDP <sup>1</sup>    | 3.0                | 3.5    | 3.5    | 3.5    | 3.5    | 3.9    | 3.9    | 3.9    | 3.9    | 4.0    | 4.0    | 4.0    | 4.0    | 3.9                          | 3.5    | 3.9    | 4.0    |
| Russia real GDP <sup>1</sup>   | 4.5                | 4.0    | 4.0    | 4.0    | 4.0    | 3.9    | 3.9    | 3.9    | 3.9    | 4.0    | 4.0    | 4.0    | 4.0    | 4.2                          | 4.0    | 3.9    | 4.0    |
| Crude oil (US\$ <sup>2</sup> ) | 93.91              | 102.99 | 93.38  | 93.38  | 90.75  | 92.00  | 92.00  | 92.00  | 92.00  | 89.75  | 89.75  | 89.75  | 89.75  | 94.92                        | 95.13  | 92.00  | 89.75  |
| Steel (US\$ <sup>3</sup> )     | 624.00             | 624.00 | 612.00 | 548.00 | 484.00 | 516.00 | 548.00 | 548.00 | 548.00 | 548.00 | 548.00 | 548.00 | 548.00 | 677.00                       | 567.00 | 540.00 | 548.00 |

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: Investment Capital Ukraine.

<sup>5</sup> London Metal Exchange ([www.lme.com](http://www.lme.com))



# Ukraine's economy

After a 0.3% quarter-on-quarter contraction in the first quarter of the year, Ukraine's economy has posted a solid growth of 0.8% QoQ in seasonally adjusted terms in the second quarter. Hence, the economy did not fall into a double-dip recession. The impact of Euro-2012 on construction, and to some extent on retail trade, spurred on the economy in the 2Q12. In the 2H12, however, there will be no such supporting factor. Instead, the agricultural sector is expected to deliver a less plentiful harvest than last season, and the industrial sector is clearly stagnating, as external demand has been gradually softening. On the back of this, we revised downward our forecast for 2012 full-year real GDP growth to 1.9% YoY from our previous call of 3.5% YoY. Similarly, we revised downward our real GDP forecast for 2013 and 2014 by 1.5ppt and 1.7ppt to 3.1% YoY and 4.0% YoY, respectively.

Lower growth projections led to wider fiscal deficits, that were lifted to the range of 1.1-1.6ppt in the 2012-13 period. Due to the negative trajectory between prices in Ukraine's two main trade sector—steel prices on the exports side and natural gas prices on the imports side—the current account deficit projection for 2012 was revised to an increase of 0.5ppt, from 4.9% of GDP as of our estimates this April to 5.4% of GDP as of July. However, there is a silver lining to our current revision of macro forecasts. In 2013, the current account deficit is projected to contract to 2.4% of GDP (back in April, the 2013 C/A deficit forecast was 3.1%), thanks to expectations for a lower crude oil price than was seen previously.

The exchange rate of the UAH versus the USD is expected to be guarded by NBU's interventionist approach to FX policy. This said, however, the hryvnia's flexibility is being allowed in a measured and gradual manner. While pursuing this approach on the UAH, Ukraine's authorities are expected to allow a reduction in FX reserves as sovereign external debt owed to the IMF is gradually paid back. We maintain our April forecast that this year's BoP shortage is to amount to more than US\$6bn, and will be covered by the use of FX reserves. Next year, in 2013, IMF lending to Ukraine is expected to resume, allowing for a BoP shortage of US\$1.5bn. In the year 2014, which precedes presidential elections, Ukraine's authorities will find it harder to adhere to the IMF programme; hence, it may be shelved again. The UAH's exchange rate, bearing a negative bias from market players, is set to weaken, as flexibility is gradually apportioned by the authorities; hence, we forecast the UAH to be at 8.30/USD at year-end 2012, and then at 8.50/USD at year-end 2013.

## Economic activity: On less solid footing

*Ukraine is likely to escape a technical recession in 2Q12, as still-vibrant household consumption supports growth; ...*

In our view, Ukraine's domestic economy has been stagnating over most of the 1H12, given the statistical data on the supply side of the economy available for the period of January-May. Official statistics reported a 2.0% YoY real increase in the quarterly GDP for 1Q12, with household demand as the primary driver of the growth, up by 9.8% YoY in the period. While fixed investments posted a quite healthy 7.6% YoY increase, it was household consumption that pulled the economy up, as it constituted a 71% of GDP in the 1Q.

Meanwhile, exports posted negative growth of 6.8% YoY, indicating that the industrial sector, which by and large exports its products and accounts for about one-quarter of GDP, was a fair disappointment. Indeed, the monthly industrial production statistics, which allow us to reconstruct a monthly index (see Chart 5), show that this part of the economy has been stagnating since January 2011—there has been no meaningful pick-up in the index since then—and it may stagnate further, as global demand has been softening well into most of 2012. In 1H12, industrial production rose by 0.4% YoY versus the same period of

2011. However, on seasonally adjusted terms, the industrial production index has been in a trend of gradual deterioration over the 1H12, particularly at the end of 2Q12. As of June 2012, the seasonally adjusted monthly industrial production index was 23% short of its pre-crisis peak.

**... going forward, however, consumption will gradually weaken as the industrial part of the economy becomes stagnant under weaker external demand**

As for household consumption, it has been providing notable support to growth in 2Q12, as June's report on retail turnover (which contributes a 15% share of GDP) showed a strong reading, partially thanks to Euro-2012 (Chart 6). In particular, over 1H12, retail trade was up 16% versus the same period of 2011, and our calculation of the seasonally adjusted monthly volumes of retail trade shows that this part of the economy has well overcome the crisis, and now stands 24% above the pre-crisis peak seen in the second half of 2008.

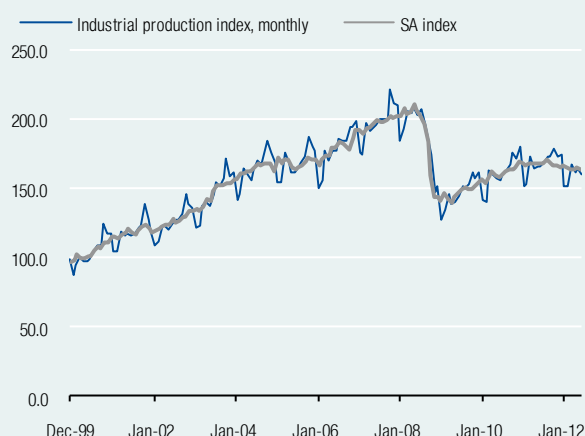
As for the other major sectors of the economy—construction and transport, which contribute a 3% and 10% share to GDP, respectively—the former saw an acceleration of activity in the sector, as preparations for the Euro-2012 held in June peaked in May (see Chart 7), while the latter was on a path of gradual deceleration in activity, as cargo as well as passenger turnover data for 1H12 were in the red (see Chart 8).

All in all, thanks to some mild impact from Euro-2012, which was evident in both the retail and construction sectors, Ukraine's economy likely escaped a technical recession in 2Q12, as seasonally-adjusted quarter-on-quarter growth should be positive in this period versus a negative 0.3% growth in the 1Q12. We estimate that real GDP growth in 2Q12 was at 2.5% YoY, implying a seasonally adjusted increase of 0.8% versus the previous quarter.

Going forward, in our view, household consumption is going to be weaker, as the pre-election fiscal stimulus spurred by President Yanukovich (social expenditures were rightfully extended before the official start of the election campaign on 1 August) will most likely be gradually counterbalanced by the persistent weakness in the private industrial sector due to falling external demand, which should create a drag on household consumption. Ultimately, we forecast a 2.4% real increase of GDP for the full-year 2012

**Chart 5. Industrial production has been stagnating since early 2011, at 20% below its December 2007 level**

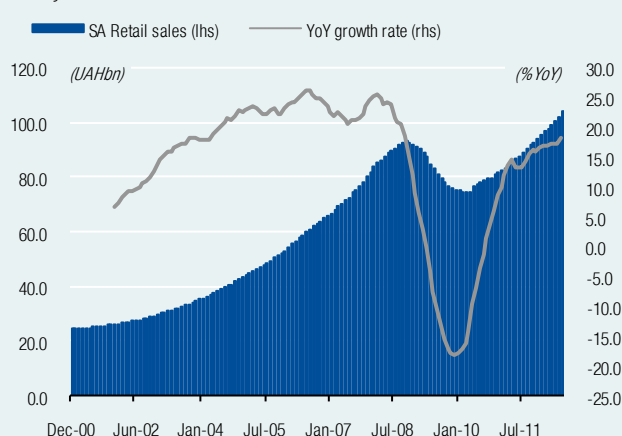
Monthly index of industrial production (100 points as of December 1999) and its seasonal-adjusted series for the same period. History till June 2012



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

**Chart 6. Consumer demand has been vibrant over the past couple of years, particularly in 1H12**

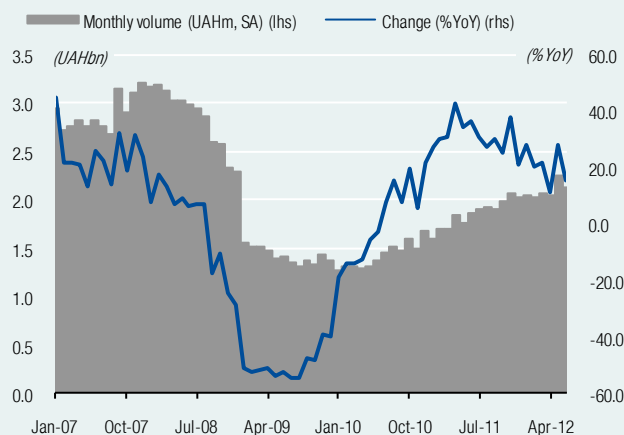
Year-on-year growth rates of retail turnover in the country. Data of retail turnover is in comparable prices and seasonally adjusted. History from December 2000 till June 2012



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

**Chart 7. Construction: monthly volume (UAHbn, left axis) and growth rate (% YoY, right axis)**

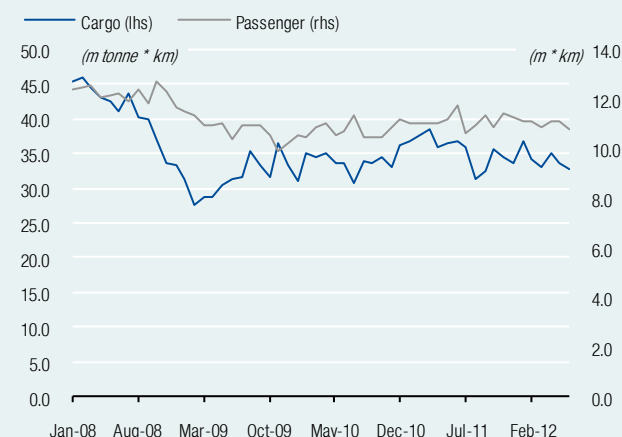
Monthly seasonally adjusted data. History till June 2012



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

**Chart 8. Transport: monthly turnover of cargos and passengers**

Monthly seasonally adjusted data. History till June 2012



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

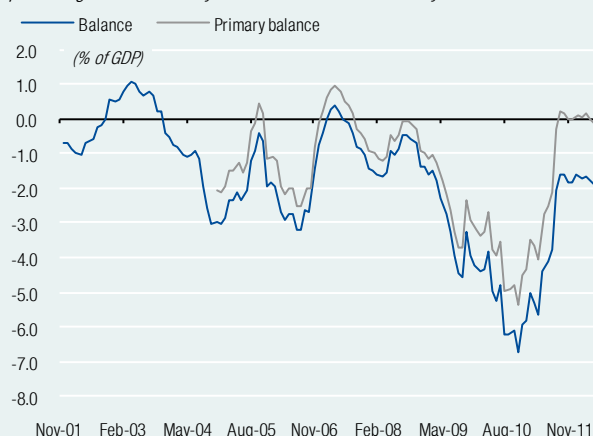
## Fiscal policy: Consolidation pauses, pre-election easing unfolds

**From Aug-11 until May-12, the government has kept the primary balance of the state budget at a near-zero level; ...**

In terms of fiscal policy, there has been a fairly remarkable fiscal consolidation by the central government—it has been running a primary balance (largely at the near zero level)—from August 2011 until the most recent period for which statistics are available, for May 2012 (see Chart 9). Along the way, the government has been quite successful in containing growth of primary expenditures, while growth of revenues was much higher, allowing the government to eliminate the primary deficit seen in 2010 and in 1H11 (see Chart 10).

**Chart 9. State budget deficit picked up in May nearing 2% of GDP**

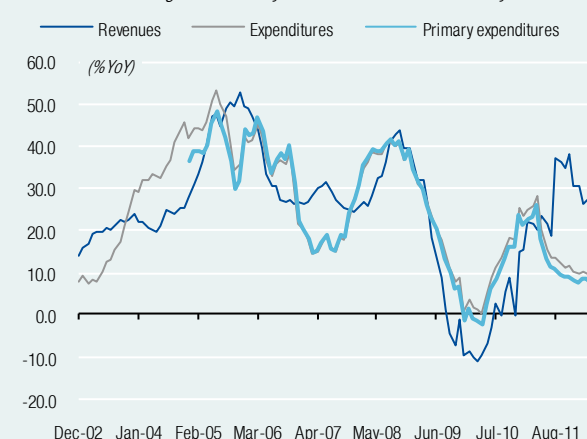
Overall and primary state budget balances on a 12-month rolling basis and as a percentage of GDP. History from November 2001 till May 2012



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

**Chart 10. Growth rate of primary expenditures rose sharply, by more than 3ppt, in May**

Year-on-year growth rates of state budget revenues and expenditures. Data is on a 12-month rolling basis. History from December 2002 till May 2012



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

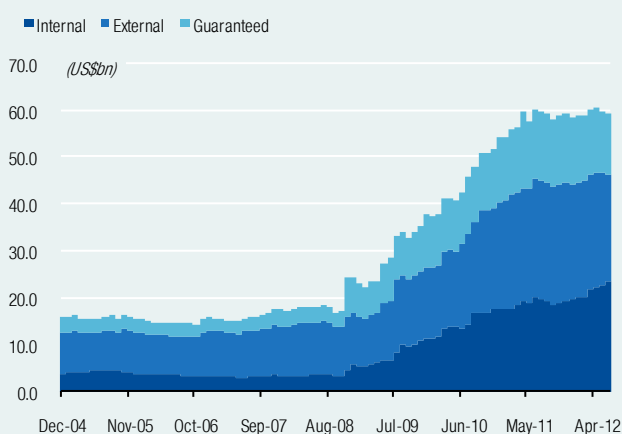
**... this tendency is about to weaken, however, as a softer economy and pre-election expenditures are to weigh on fiscal policy**

However, the above-mentioned, positive trend is likely to reverse due to the economic slowdown of this year, which will engender state budget revenues of below the government's target, and include additional expenditures that were introduced into the state budget law in 1Q12. Hence, we expect that the primary balance will move into the red in 3Q12, and somewhat tighten in 2013, in order to strengthen public finances after parliamentary elections. However, the government is likely to allow a larger deficit again in 2014, in order to prepare for President Yanukovich's likely re-election to the presidency in 1Q15.

Going forward, our base-case scenario envisages a gradual pick up of the public debt<sup>6</sup> level (in terms of share of GDP) from the current 35% as of end-1H12 to 38-40%, as weaker economic growth in real and nominal terms and a pre-election increase in budget expenditures spell an end to the declining trend in the debt-to-GDP ratio seen in the 2H11 and 1H12.

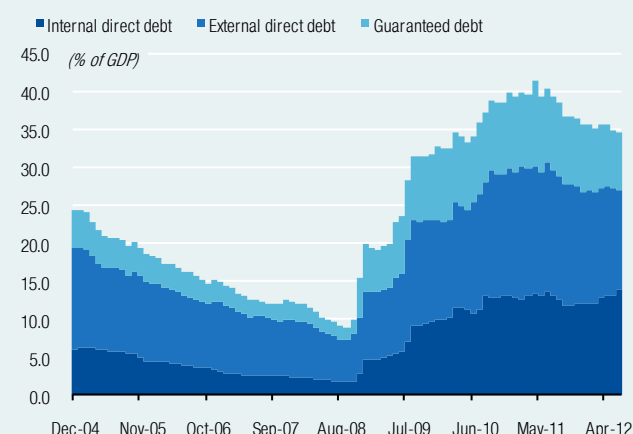
**Chart 11. Public debt size in absolute terms (left, US\$bn) and relative terms (right, % of GDP). History through June 2012**

*Ukraine's public debt in US\$ equivalent*



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

*Ukraine's public debt as percentage of GDP*



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

## Monetary policy: “Muddle-through” approach

**NBU has been very cautious on moving away from the de-facto USD-pegged FX regime, ...**

In terms of monetary policy, authorities have been practicing a strategy of maintaining a thin balance between supporting the banking sector as well as the flow of credit in a functional manner, and keeping at bay any run on the local currency stemming from a deteriorating outlook on the part of both local businesses and the public on the authorities' FX regime of a de-facto peg of the UAH to the US dollar.

The NBU has been quite cautious in terms of shifting away from its FX policy of a pure peg to the USD towards a more flexible regime. Negative balance of payments developments in 2011 and in 2012 forced the NBU to reduce its FX reserves while defending the UAH's nominal stability on the local FX market. This monetary policy strategy resulted in quite limited monetary expansion, with base money growth declining towards 4% YoY and inflation-adjusted money supply growth to 11% YoY in May 2012 (see Chart 12 and Chart 13).

<sup>6</sup> This includes direct debt as well as guaranteed debt.



**... crystallising this approach into its monetary stance that will be held till the end of 2H12**

While such monetary conditions spawn a high interest rate environment in the economy and lower bank lending activity, they have nevertheless been guarding the banking sector from a currency run like the one that took place in late 2008, when the NBU's refinancing operations with domestic banks resulted in hyper-lending activity, despite an interest rate spike. A widely held view is that such an abrupt liquidity injection ended up in the FX market, where a runaway devaluation of the local currency, the hryvnia, took place.

In 2H12, Ukraine's authorities are going to try to preserve a kind of *status quo* in fiscal and monetary policymaking, with the aim to smooth out the political outcome of this fall's parliamentary elections, i.e., to allow ruling incumbents to stay in power, via realising socially friendly policies like raising pensions and public sector wages. The exchange-rate policy is also a part of the so-called "social package" that the ruling parties are attempting to include as a part of their elections aspirations this year.

**Chart 12. Money-creation by NBU has been extremely slow in the face of vulnerabilities of the domestic finances to pending global crisis**

Year-on-year growth rates of monetary base and nominal GDP. History from December 2003 till May 2012. Data on GDP is 12-month rolling



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

**Chart 13. Money supply in the economy – too tight for the economy that struggles with recovery from deep recession in 2008-09**

Year-on-year growth rates of CPI-adjusted data on monetary aggregates. History from January 1997 till May 2012



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

Given that economy is expected to still be delivering growth in the 2H, albeit at a slower pace (of 2.4% YoY) than in 2011, which is our base case scenario, and external markets for Ukraine's exports are expected to recover over this period as well, Ukraine's authorities will realise in 2H their favoured strategy of "muddling through," i.e., giving up an activist monetary policy for the sake of providing in large part a kind of stability of the USD/UAH exchange rate until the end of this year. This approach also implies that going forward, monetary policy will gradually shift towards greater flexibility of the USD/UAH exchange rate. This approach corresponds with our FX forecasts for the 2012-14 period (see Table 3 and Table 4, pp.21-22).

## Balance of payments: Current account little changed, capital flows out

**The external balance is by and large a function of trade in minerals**

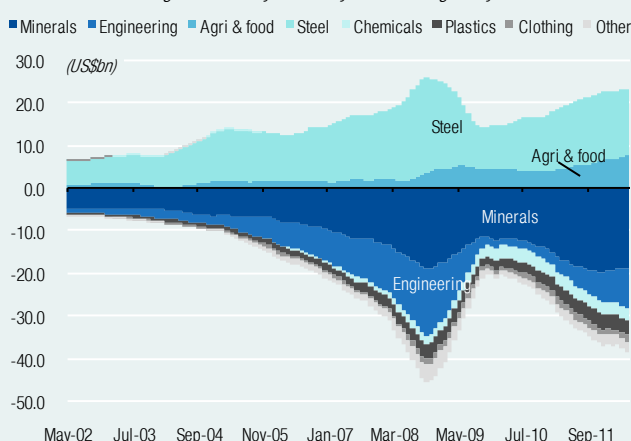
Our view on the future shape of the balance of payments has just marginally evolved since our previous publication of the *Quarterly Report* in early April of this year. Minerals trade is a cornerstone of the current account deficit in Ukraine of more than 5% of GDP. Although only recently, over 2Q12, imports of engineering goods, which include machinery and transport vehicles, accelerated quite noticeably (see charts below).

**However, imports of transport vehicles were robust in 1H12, too, but there are one-off factors contributing to the rise of imports**

This has been especially true with regard to transport vehicles imports, which rose in May by 39.8% MoM, while machinery imports' monthly increase was quite modest, at 0.1% MoM. We associate the increase with two factors: first, Euro-2012 has forced the government to modernise some parts of its railway stock via purchasing high-speed, Korean-made locomotives; and, second, a likely one-off, abnormal spike in marine vessel imports in May<sup>7</sup>. These factors will likely not play a factor in trade going forward. This year's spike in transport vehicle imports, while increasingly similar to what was seen in early 2008, was nevertheless less consumer-driven. Then, in July 2008, credit-driven purchases of imported cars yielded a 94% share of surface vehicles imports (which are cars) in the total volume of imports of transport vehicles. There is no such dramatic bias in these kinds of purchases, as the share of surface vehicles (cars) in May was 52%. The rest, as was described above, was in imports of rail locomotives (an impact from Euro-2012) and of marine vessels (the impact of likely one-off, non-mass market purchases by the wealthy).

**Chart 14. Trade balances in key merchandise groups (US\$bn)**

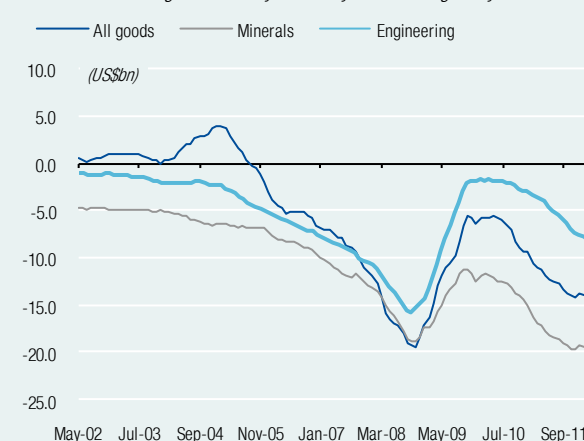
Last 12-month rolling data. History from May 2002 through May 2012



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

**Chart 15. Trade balance of goods (all goods) versus the trade balances of two deficit groups: minerals and engineering (US\$bn)**

Last 12-month rolling data. History from May 2002 through May 2012



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

**Crude oil price projections for 2012-14 provide a lower natural gas price in 2H12 and 2013, ...**

As Chart 15 shows, the 12-month, rolling trade deficit in minerals peaked to near US\$19.7bn in November 2011, and then subsided to US\$18.9bn this May. This deficit is set to gradually decline over 2H12 and 2013, as our current forecast on imported natural gas price based upon crude oil price projections brings lower prices than the previous forecast made this April.

However, still, this year's average price of US\$419 per 1,000 m<sup>3</sup> is up 27.6% from 2011's average price of US\$329, implying that despite the government's confirmation that this year's total imports of natural gas will be at 35bcm, down from 44bcm in 2011, this year's current account deficit is projected to be slightly higher than in 2011 (see Chart 17).

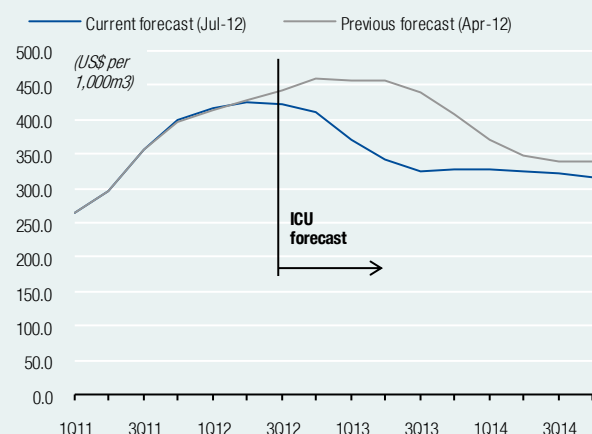
<sup>7</sup> In May 2012, imports of marine vessels amounted to US\$393.1m up by 145.7x from US\$2.7m of monthly imports seen in April 2012. A breakdown of monthly import volume of transport vehicles provides a more revealing picture why such an extraordinary rise took place in this category of merchandise imports: while in April 2012 surface vehicles imports were 79.4%; rail locomotives imports were at 18.1%; and marine vessels imports were a mere 0.3%; then in May 2012, the share of marine vessel imports in total monthly imports amounted to 35.8%, suppressing the share of rail locomotives imports to 11.2%, while the share of surface vehicles imports declined to 52.7%.

**... leading to a lower  
current account deficit  
for 2013**

In 2013, the imported natural gas price for Naftogaz is set to decline by 18.6% to a full-year average of US\$341, which (together with a lowered physical volume of natural gas imports of 32bcm) would translate into a lower volume of total imports, helped by a pick-up in steel prices (which are forecast to drop in 2H12 before recovering in 2013; see Chart 4 on pp.11). Eventually, the current account deficit for the full-year 2013 is forecast to contract towards US\$4.7bn, or 2.4% of GDP.

**Chart 16. ICU forecast of natural gas price for Naftogaz imports**

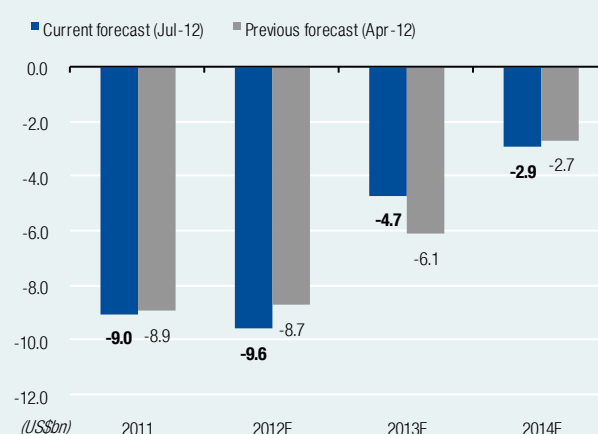
Quarterly price levels in US\$ per 1,000 cubic metres



Source: Bloomberg, Investment Capital Ukraine LLC.

**Chart 17. ICU forecast of current account balance (US\$bn)**

Forecast for 2012-14 years, data for 2011 is historical



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

With regard to capital flows in the rest of 2012 and in full years of 2013 and 2014, we have updated our April balance of payments (BoP) model, which was constructed originally for 2012 only, extending it into the next two-year period (Table 2, pp.20). While constructing the model, we made the following assumptions.

First, regarding external debt owed by authorities, we took into account the debt repayments made to date in 2012 by the NBU and the government to the IMF, VTB, and Eurobond market investors, as well as the recent Eurobond sovereign bond issue of US\$2bn. For the rest of 2012, the assumption is that there will be no IMF lending restored.

Second, in 2013, Ukraine's authorities are likely to benefit from the IMF programme; however, they would secure a 50% roll-over ratio for the IMF debt due that year and owned by the NBU. Government is forecast to finance itself from the markets, tapping the Eurobond market with a US\$2bn issue each year in 2013-14. In 2014, Ukraine's authorities are to start preparing for presidential elections in 1Q15, and this would put the IMF programme in pause again; hence, the IMF debt due that year has a 0% roll-over ratio.

Third, VTB's US\$2bn loan, half of which was to be redeemed this June, and half prolonged until 2014, will be either repackaged into a tradable Eurobond with an extended maturity (i.e., beyond 2014) or eventually redeemed in 2014. This model assumes the latter.

Fourth, banks' deleveraging is to extend into 2013-14 at the same pace as is assumed for 2012. They are to redeem their Eurobonds due in this period and continue repaying other external debt with a rollover ratio of 77%, which we deem as healthy pace of deleveraging that does not prompt a flight of capital from the country.

Fifth, the corporate sector is assumed to have better access to external creditors than banks, and its roll-over ratio will be above 100%, effectively meaning a net inflow of capital into the economy.

## Conclusion

Our BoP model for the 2012-14 period yields the following results: to a broad extent, it confirms our previous assessment for 2012 (made in the previous issue of our Quarterly Report) that more than US\$6bn of FX reserves will be spent this year by the NBU to cover BoP needs, and in the following years of 2013 and 2014, there will be nearly counterbalancing changes in FX reserves, as a US\$1.5bn FX reserves loss in 2013 would be offset by an addition of US\$1.5bn to reserves during 2014.

**Table 2. Assessment of the balance of payments in 2012-14 from the perspective of current account size and capital account flows**

|   | Balance of payments (US\$bn) |                |                    | Rollover ratios   |      |      |   |
|---|------------------------------|----------------|--------------------|-------------------|------|------|---|
|   | 2012                         | 2013           | 2014               | 2012              | 2013 | 2014 | Comment   |
| <b>Current account balance</b>          | <b>-9,569</b>                | <b>-4,683</b>  | <b>-2,925</b>      |                   |      |      |   |
| Short-term debt due next 12-months      | -55,799                      | -57,613        | -60,560            |                   |      |      |   |
| <b>Government</b>                       |                              |                |                    |                   |      |      |   |
| Official lenders (IMF)                  | -757                         | -2,566         | -2,555             | 0%                | 0%   | 0%   | ICU assumption  |
| Russian banks (VTB)                     | -1,000                       | 0              | -1,000             | 0%                | 0%   | 0%   | ICU assumption  |
| Eurobonds                               | -500                         | -1,000         | 0                  | 400% <sup>6</sup> | 200% | 0%   | ICU assumption  |
| Domestic bonds in frgn ccy <sup>5</sup> | -420                         | -1,606         | -171               | 100%              | 100% | 100% | ICU assumption  |
| Other                                   | -946                         | 1,550          | 104                | 100%              | 100% | 100% | All-time avg roll-over ratio for authorities (BoP monthly data)         |
| <b>Central bank</b>                     |                              |                |                    |                   |      |      |   |
| Official lenders (IMF)                  | -2,617                       | -3,191         | -1,051             | 0%                | 50%  | 0%   | ICU assumption  |
| Other                                   | -74                          | 0              | 0                  | 0%                | 0%   | 0%   | ICU assumption  |
| <b>Banks</b>                            |                              |                |                    |                   |      |      |   |
| Eurobonds                               | -1,106                       | -15            | -479               | 0%                | 0%   | 0%   | ICU assumption  |
| Other lenders                           | -11,796                      | -9,114         | -7,042             | 77%               | 77%  | 77%  | All-time avg roll-over ratio for banks (BoP monthly data) <sup>1</sup>  |
| <b>Corporations</b>                     |                              |                |                    |                   |      |      |   |
| Eurobonds                               | -225                         | 0              | -1,645             | 0%                | 0%   | 90%  | ICU assumption  |
| Loans                                   | -10,691                      | -12,253        | -13,738            | 113%              | 113% | 113% | All-time avg roll-over ratio for corporations (BoP monthly data)        |
| Trade loans                             | -17,579                      | -20,147        | -22,588            | 113%              | 113% | 113% | The same as above   |
| Other                                   | -8,089                       | -9,271         | -10,394            | 124%              | 113% | 113% | The same as above and net of inflow of election money <sup>2</sup>      |
| Demand for currency by local savers     | -3,437                       | -4,437         | -4,437             |                   |      |      | All-time avg (BoP monthly data) net of inflow of Euro-2012 <sup>3</sup> |
| <b>Total financing needs</b>            | <b>-68,805</b>               | <b>-66,734</b> | <b>-67,922</b>     |                   |      |      |   |
| FDI, inflows                            | 7,503                        | 7,564          | 7,682              |                   |      |      | ICU forecast for the period   |
| <b>Borrowings</b>                       |                              |                |                    |                   |      |      |   |
| Government                              | 3,365                        | 2,056          | 2,067 <sup>7</sup> |                   |      |      | ICU calculations based on debt due <sup>4</sup> and roll-over ratios    |
| Central bank                            | 0                            | 1,595          | 0                  |                   |      |      | ICU calculations based on debt due <sup>4</sup> and roll-over ratios    |
| Banks                                   | 9,114                        | 7,042          | 5,441              |                   |      |      | ICU calculations based on debt due <sup>4</sup> and roll-over ratios    |
| Corporations                            | 41,929                       | 47,010         | 54,186             |                   |      |      | ICU calculations based on debt due <sup>4</sup> and roll-over ratios    |
| <b>Total financing</b>                  | <b>61,912</b>                | <b>65,267</b>  | <b>69,376</b>      |                   |      |      |   |
| <b>Addition to (use of) FX reserves</b> | <b>-6,894</b>                | <b>-1,467</b>  | <b>+1,454</b>      |                   |      |      |   |

Notes: [1] adjusted up by 38%; [2] election money inflow is assessed to be at US\$1.5bn in 2012; [3] football fans' money spent during the tournament assessed to be at US\$1.0bn; [4] debt due in the period; [5] foreign currency denominated sovereign bonds issued at the domestic debt market; [6] this roll-over ratio reflects the fact that the MoF borrowed US\$2bn from the Eurobond market on 17 July 2012; [7] this figure includes a US\$2bn Eurobond issue by Ukraine's government.

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

## Yearly forecast for 2012-14, base-case scenario

Table 3. Forecast of key macroeconomic indicators for 2012-14 (annual)

|                                      | 2002  | 2003  | 2004  | Historical data for 2002-11 |       |       |       |       |       |       | Forecast by ICU |       |       |
|--------------------------------------|-------|-------|-------|-----------------------------|-------|-------|-------|-------|-------|-------|-----------------|-------|-------|
|                                      |       |       |       | 2005                        | 2006  | 2007  | 2008  | 2009  | 2010  | 2011  | 2012F           | 2013F | 2014F |
| Activity                             |       |       |       |                             |       |       |       |       |       |       |                 |       |       |
| Real GDP (%YoY)                      | 5.2   | 9.6   | 12.1  | 2.7                         | 7.3   | 7.9   | 2.3   | -14.8 | 4.2   | 5.1   | 1.9             | 3.1   | 4.0   |
| Nominal GDP (UAHbn)                  | 226   | 267   | 345   | 441                         | 544   | 721   | 948   | 913   | 1,083 | 1,327 | 1,447           | 1,667 | 1,895 |
| Nominal GDP (US\$bn)                 | 42    | 50    | 65    | 87                          | 108   | 143   | 184   | 114   | 136   | 166   | 178             | 196   | 229   |
| GDP per capita (US\$, ann)           | 874   | 1,044 | 1,371 | 1,850                       | 2,319 | 3,091 | 3,982 | 2,474 | 2,977 | 3,643 | 3,902           | 4,315 | 5,050 |
| Unemployment rate (%)                | 9.6   | 9.1   | 8.6   | 7.2                         | 6.2   | 6.4   | 6.4   | 8.8   | 8.1   | 8.2   | 7.9             | 7.9   | 7.9   |
| Prices                               |       |       |       |                             |       |       |       |       |       |       |                 |       |       |
| CPI headline (%YoY, eop)             | -0.6  | 8.2   | 12.3  | 10.3                        | 11.6  | 16.6  | 22.3  | 12.3  | 9.1   | 4.6   | 4.4             | 8.7   | 5.4   |
| CPI headline (%YoY, average)         | 0.8   | 5.2   | 9.0   | 13.6                        | 9.1   | 12.8  | 25.3  | 16.0  | 9.4   | 8.0   | 1.6             | 8.5   | 6.3   |
| PPI (%YoY, eop)                      | 5.8   | 11.2  | 24.3  | 9.6                         | 15.4  | 23.2  | 21.1  | 15.3  | 18.8  | 17.4  | 11.2            | 9.4   | 7.4   |
| PPI (%YoY, average)                  | 3.1   | 7.8   | 20.3  | 17.0                        | 9.6   | 20.5  | 33.6  | 7.4   | 21.4  | 19.9  | 9.2             | 10.6  | 8.3   |
| Fiscal balance                       |       |       |       |                             |       |       |       |       |       |       |                 |       |       |
| Consolidated budget bal. (UAHbn)     | 1.7   | -0.5  | -11.8 | -7.7                        | -3.7  | -7.7  | -24.9 | -67.5 | -63.3 | -18.3 | -62.1           | -58.5 | -66.5 |
| Consolidated budget bal. (% of GDP)  | 0.8   | -0.2  | -3.4  | -1.7                        | -0.7  | -1.1  | -2.6  | -7.4  | -5.9  | -1.4  | -4.3            | -3.5  | -3.5  |
| Budget balance (UAHbn)               | 1.2   | -1.0  | -10.2 | -7.9                        | -3.8  | -9.8  | -12.5 | -32.7 | -63.0 | -11.0 | -51.4           | -52.4 | -59.6 |
| Budget balance (% of GDP)            | 0.5   | -0.4  | -3.0  | -1.8                        | -0.7  | -1.4  | -1.3  | -3.6  | -5.8  | -0.8  | -3.6            | -3.1  | -3.1  |
| External balance                     |       |       |       |                             |       |       |       |       |       |       |                 |       |       |
| Exports (US\$bn)                     | 23.4  | 29.0  | 41.3  | 44.4                        | 50.2  | 64.0  | 85.6  | 54.3  | 69.3  | 88.8  | 87.4            | 91.3  | 96.9  |
| Imports (US\$bn)                     | 21.5  | 27.7  | 36.3  | 43.7                        | 53.3  | 71.9  | 100.1 | 56.2  | 73.2  | 97.8  | 96.9            | 96.0  | 99.7  |
| Trade balance (US\$bn)               | 1.9   | 1.3   | 5.0   | 0.7                         | -3.1  | -7.9  | -14.5 | -2.0  | -4.0  | -8.9  | -9.6            | -4.7  | -2.9  |
| Trade balance (% of GDP)             | 4.4   | 2.6   | 7.7   | 0.8                         | -2.8  | -5.5  | -7.9  | -1.7  | -2.9  | -5.4  | -5.4            | -2.4  | -1.3  |
| Current account balance (US\$bn)     | 3.2   | 2.9   | 6.9   | 2.5                         | -1.6  | -5.9  | -12.9 | -1.7  | -3.0  | -9.0  | -9.6            | -4.7  | -2.9  |
| Current account balance (% of GDP)   | 7.5   | 5.8   | 10.6  | 2.9                         | -1.5  | -4.1  | -7.0  | -1.5  | -2.2  | -5.4  | -5.4            | -2.4  | -1.3  |
| Net FDI (US\$bn)                     | 0.7   | 1.4   | 1.7   | 7.5                         | 5.7   | 9.2   | 9.7   | 4.7   | 5.8   | 7.0   | 7.5             | 7.6   | 7.7   |
| Net FDI (% of GDP)                   | 1.6   | 2.8   | 2.6   | 8.7                         | 5.3   | 6.4   | 5.3   | 4.1   | 4.2   | 4.2   | 4.2             | 3.9   | 3.3   |
| C/A bal. + net FDI (% of GDP)        | 9.1   | 8.6   | 13.3  | 11.6                        | 3.8   | 2.3   | -1.8  | 2.6   | 2.0   | -1.2  | -1.2            | 1.5   | 2.1   |
| External debt (US\$bn, eop)          | N/A   | 23.8  | 30.6  | 39.6                        | 54.5  | 80.0  | 101.7 | 103.4 | 117.3 | 126.2 | 129.9           | 131.5 | 133.4 |
| External debt (% of ann'd GDP, eop)  | N/A   | 47.5  | 47.2  | 45.6                        | 50.4  | 55.8  | 55.3  | 90.9  | 86.1  | 75.9  | 72.9            | 67.0  | 58.2  |
| FX reserves (US\$bn, eop)            | 4.2   | 6.9   | 9.5   | 19.4                        | 22.3  | 32.5  | 31.5  | 26.5  | 34.6  | 32.8  | 24.9            | 23.4  | 24.9  |
| FX reserves (% of ann'd GDP, eop)    | 10.0  | 13.8  | 14.7  | 22.3                        | 20.6  | 22.6  | 17.2  | 23.3  | 25.4  | 19.7  | 14.0            | 12.0  | 10.9  |
| External debt / FX reserves (x, eop) | N/A   | 3.4   | 3.2   | 2.0                         | 2.4   | 2.5   | 3.2   | 3.9   | 3.4   | 3.9   | 5.2             | 5.6   | 5.4   |
| FX reserves imports cov (months)     | 2.8   | 3.6   | 3.8   | 6.4                         | 6.1   | 6.4   | 4.5   | 7.1   | 6.8   | 4.7   | 3.1             | 2.9   | 3.0   |
| Interest rates                       |       |       |       |                             |       |       |       |       |       |       |                 |       |       |
| Central bank key rate (% eop)        | 7.00  | 7.00  | 9.00  | 9.50                        | 8.50  | 8.00  | 12.00 | 10.25 | 7.75  | 7.75  | 7.25            | 7.00  | 7.00  |
| 3-month rate (% eop 4Q)              | N/A   | 17.91 | 15.03 | 11.46                       | 9.90  | 7.58  | 21.60 | 17.59 | 6.12  | 19.72 | 8.00            | 8.00  | 8.00  |
| Exchange rates                       |       |       |       |                             |       |       |       |       |       |       |                 |       |       |
| UAH trade-weighted index (nominal)   | 77.64 | 66.81 | 67.19 | 77.84                       | 70.90 | 64.93 | 45.89 | 46.09 | 53.28 | 56.87 | 53.85           | 52.50 | 52.47 |
| UAH trade-weighted index (real)      | 70.35 | 67.17 | 70.39 | 80.94                       | 74.89 | 70.21 | 52.42 | 49.11 | 54.76 | 54.70 | 53.95           | 54.30 | 52.35 |
| UAH/US\$ (eop)                       | 5.33  | 5.33  | 5.31  | 5.05                        | 5.05  | 5.05  | 7.80  | 8.00  | 7.97  | 8.00  | 8.30            | 8.50  | 8.20  |
| UAH/US\$ (average)                   | 5.33  | 5.33  | 5.32  | 5.10                        | 5.03  | 5.03  | 5.25  | 8.03  | 7.95  | 8.03  | 8.14            | 8.50  | 8.28  |
| UAH/€ (eop)                          | 4.75  | 5.60  | 6.71  | 7.20                        | 5.97  | 6.66  | 7.36  | 10.90 | 11.45 | 10.66 | 10.21           | 10.20 | 9.84  |
| UAH/€ (average)                      | 5.04  | 6.04  | 6.62  | 6.35                        | 6.32  | 6.89  | 7.67  | 11.19 | 10.54 | 10.51 | 10.23           | 10.26 | 9.93  |
| US\$/€ (eop)                         | 1.05  | 1.26  | 1.36  | 1.18                        | 1.32  | 1.46  | 1.40  | 1.43  | 1.34  | 1.30  | 1.23            | 1.20  | 1.20  |
| US\$/€ (average)                     | 0.95  | 1.13  | 1.24  | 1.24                        | 1.26  | 1.37  | 1.47  | 1.39  | 1.33  | 1.31  | 1.26            | 1.21  | 1.20  |
| Population                           |       |       |       |                             |       |       |       |       |       |       |                 |       |       |
| Population (million, eop)            | 48.5  | 48.0  | 47.3  | 47.0                        | 46.6  | 46.4  | 46.1  | 46.0  | 45.8  | 45.6  | 45.5            | 45.4  | 45.4  |
| Population (%YoY)                    | -1.0  | -0.9  | -1.4  | -0.8                        | -0.7  | -0.6  | -0.5  | -0.4  | -0.4  | -0.3  | -0.3            | -0.1  | -0.1  |

Notes: eop – end of period; cov. – coverage; con'd – consolidated; ann – annualised.

Sources: State Statistics Committee of Ukraine, National Bank of Ukraine, Investment Capital Ukraine LLC.

## Quarterly forecast for 2012-14, base-case scenario

Table 4. Forecast of key macroeconomic indicators for 2012-14 (quarterly)

|                                      |       | Quarterly forecast by ICU |       |       |       |       |       |       |       |       |       |       |       |
|--------------------------------------|-------|---------------------------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
|                                      | 4Q11  | 1Q12                      | 2Q12E | 3Q12F | 4Q12F | 1Q13F | 2Q13F | 3Q13F | 4Q13F | 1Q14F | 2Q14F | 3Q14F | 4Q14F |
| Activity                             |       |                           |       |       |       |       |       |       |       |       |       |       |       |
| Real GDP (%YoY)                      | 4.6   | 2.0                       | 2.5   | 1.0   | 2.0   | 2.0   | 2.0   | 3.5   | 5.0   | 4.0   | 4.0   | 4.0   | 4.0   |
| Nominal GDP (UAHbn)                  | 359.3 | 297.0                     | 342.3 | 404.7 | 402.6 | 338.2 | 389.5 | 469.1 | 470.1 | 388.1 | 443.3 | 532.1 | 531.1 |
| Nominal GDP (US\$bn)                 | 44.9  | 37.0                      | 42.5  | 49.7  | 48.5  | 39.8  | 45.8  | 55.2  | 55.3  | 45.7  | 54.1  | 64.9  | 64.8  |
| GDP per capita (US\$, ann)           | 3,640 | 3,704                     | 3,772 | 3,832 | 3,901 | 3,963 | 4,037 | 4,160 | 4,311 | 4,441 | 4,623 | 4,836 | 5,045 |
| Unemployment rate (%)                | 8.2   | 8.4                       | 7.9   | 7.9   | 7.9   | 7.9   | 7.9   | 7.9   | 7.9   | 7.9   | 7.9   | 7.9   | 7.9   |
| Prices                               |       |                           |       |       |       |       |       |       |       |       |       |       |       |
| CPI headline (%YoY, eop)             | 4.6   | 1.9                       | -1.2  | 1.4   | 4.4   | 7.0   | 9.8   | 9.6   | 8.7   | 7.1   | 6.1   | 5.7   | 5.4   |
| CPI headline (%YoY, average)         | 5.0   | 2.9                       | -0.4  | 0.7   | 3.4   | 6.2   | 9.1   | 9.7   | 9.1   | 7.6   | 6.2   | 6.0   | 5.5   |
| PPI (%YoY, eop)                      | 17.4  | 9.5                       | 7.5   | 7.7   | 11.2  | 12.5  | 9.9   | 10.2  | 9.4   | 8.9   | 8.4   | 7.9   | 7.4   |
| PPI (%YoY, average)                  | 19.2  | 11.7                      | 8.2   | 7.8   | 9.0   | 12.7  | 9.7   | 10.3  | 9.7   | 9.1   | 8.6   | 8.1   | 7.6   |
| Fiscal balance                       |       |                           |       |       |       |       |       |       |       |       |       |       |       |
| Consolidated budget bal. (UAHbn)     | -18.1 | -0.4                      | -17.2 | -6.6  | -38.0 | -2.6  | -16.1 | -1.2  | -38.6 | -1.8  | -18.1 | -1.7  | -44.9 |
| Consolidated budget bal. (% of GDP)  | -5.0  | -0.1                      | -5.0  | -1.6  | -9.4  | -0.8  | -4.1  | -0.3  | -8.2  | -0.5  | -4.1  | -0.3  | -8.4  |
| Budget balance (UAHbn)               | -13.5 | 1.3                       | -14.7 | -6.8  | -31.1 | -3.5  | -14.1 | -2.9  | -31.9 | -3.1  | -15.9 | -3.6  | -37.0 |
| Budget balance (% of GDP)            | -3.8  | 0.4                       | -4.3  | -1.7  | -7.7  | -1.0  | -3.6  | -0.6  | -6.8  | -0.8  | -3.6  | -0.7  | -7.0  |
| External balance                     |       |                           |       |       |       |       |       |       |       |       |       |       |       |
| Exports (US\$bn)                     | 23.5  | 20.7                      | 22.1  | 21.7  | 22.8  | 21.8  | 22.7  | 22.5  | 24.4  | 23.8  | 23.8  | 23.6  | 25.7  |
| Imports (US\$bn)                     | 27.1  | 22.5                      | 23.3  | 23.9  | 27.2  | 23.4  | 23.0  | 23.6  | 26.0  | 24.3  | 24.2  | 24.5  | 26.7  |
| Trade balance (US\$bn)               | -3.6  | -1.8                      | -1.2  | -2.2  | -4.4  | -1.6  | -0.4  | -1.1  | -1.6  | -0.6  | -0.3  | -0.9  | -1.0  |
| Trade balance (% of GDP)             | -7.9  | -4.9                      | -2.8  | -4.5  | -9.0  | -4.0  | -0.9  | -2.0  | -2.9  | -1.3  | -0.6  | -1.4  | -1.6  |
| Current account balance (US\$bn)     | -4.0  | -1.3                      | -1.4  | -2.2  | -4.6  | -1.3  | -0.5  | -1.1  | -1.7  | -0.4  | -0.4  | -0.9  | -1.1  |
| Current account balance (% of GDP)   | -8.9  | -3.6                      | -3.3  | -4.5  | -9.5  | -3.3  | -1.1  | -2.1  | -3.1  | -1.0  | -0.8  | -1.4  | -1.7  |
| Net FDI (US\$bn)                     | 1.6   | 1.7                       | 2.0   | 2.0   | 1.8   | 1.8   | 1.9   | 1.9   | 1.9   | 1.9   | 1.9   | 1.9   | 1.9   |
| Net FDI (% of GDP)                   | 3.6   | 4.5                       | 4.8   | 4.0   | 3.8   | 4.5   | 4.2   | 3.5   | 3.4   | 4.1   | 3.6   | 3.0   | 3.0   |
| C/A bal. + net FDI (% of GDP)        | -5.3  | 0.9                       | 1.5   | -0.5  | -5.7  | 1.2   | 3.1   | 1.4   | 0.3   | 3.1   | 2.8   | 1.6   | 1.3   |
| External debt (US\$bn, eop)          | 126.2 | 126.9                     | 130.8 | 128.8 | 129.9 | 130.0 | 129.2 | 129.5 | 131.5 | 131.6 | 132.7 | 131.4 | 133.4 |
| External debt (% of ann'd GDP, eop)  | 75.9  | 75.1                      | 76.0  | 73.5  | 72.9  | 71.9  | 70.1  | 68.4  | 67.0  | 65.2  | 63.1  | 59.7  | 58.2  |
| FX reserves (US\$bn, eop)            | 32.8  | 31.1                      | 29.3  | 27.6  | 24.9  | 24.5  | 24.2  | 23.8  | 23.4  | 23.8  | 24.2  | 24.5  | 24.9  |
| FX reserves (% of ann'd GDP, eop)    | 19.7  | 18.4                      | 17.0  | 15.8  | 14.0  | 13.6  | 13.2  | 12.6  | 12.0  | 11.8  | 11.5  | 11.2  | 10.9  |
| External debt / FX reserves (x, eop) | 3.9   | 4.1                       | 4.5   | 4.7   | 5.2   | 5.3   | 5.3   | 5.4   | 5.6   | 5.5   | 5.5   | 5.4   | 5.4   |
| FX reserves imports cov (months)     | 4.7   | 4.5                       | 3.6   | 3.4   | 3.1   | 3.0   | 3.0   | 2.9   | 2.9   | 2.9   | 3.0   | 3.0   | 3.0   |
| Interest rates                       |       |                           |       |       |       |       |       |       |       |       |       |       |       |
| Central bank key rate (% eop)        | 7.75  | 7.50                      | 7.25  | 7.25  | 7.25  | 7.00  | 7.00  | 7.00  | 7.00  | 7.00  | 7.00  | 7.00  | 7.00  |
| 3-month rate (% eop 4Q)              | 19.72 | 15.34                     | 12.00 | 10.00 | 8.00  | 10.00 | 10.00 | 10.00 | 10.00 | 8.00  | 8.00  | 8.00  | 8.00  |
| Exchange rates                       |       |                           |       |       |       |       |       |       |       |       |       |       |       |
| UAH trade-weighted index (nominal)   | 56.87 | 53.81                     | 56.94 | 54.94 | 53.85 | 52.27 | 52.50 | 52.50 | 52.50 | 50.61 | 52.47 | 52.47 | 52.47 |
| UAH trade-weighted index (real)      | 54.70 | 50.94                     | 52.79 | 51.46 | 53.95 | 52.80 | 53.45 | 53.88 | 54.30 | 51.89 | 53.31 | 52.83 | 52.35 |
| UAH/US\$ (eop)                       | 8.00  | 8.03                      | 8.08  | 8.15  | 8.30  | 8.50  | 8.50  | 8.50  | 8.50  | 8.50  | 8.20  | 8.20  | 8.20  |
| UAH/US\$ (average)                   | 8.01  | 8.02                      | 8.05  | 8.15  | 8.30  | 8.50  | 8.50  | 8.50  | 8.50  | 8.50  | 8.20  | 8.20  | 8.20  |
| UAH/€ (eop)                          | 10.36 | 10.72                     | 10.23 | 9.94  | 10.21 | 10.46 | 10.20 | 10.20 | 10.20 | 10.20 | 9.84  | 9.84  | 9.84  |
| UAH/€ (average)                      | 10.13 | 10.20                     | 10.11 | 9.94  | 10.21 | 10.46 | 10.20 | 10.20 | 10.20 | 10.20 | 9.84  | 9.84  | 9.84  |
| US\$/€ (eop)                         | 1.31  | 1.33                      | 1.27  | 1.22  | 1.23  | 1.23  | 1.20  | 1.20  | 1.20  | 1.20  | 1.20  | 1.20  | 1.20  |
| US\$/€ (average)                     | 1.31  | 1.31                      | 1.26  | 1.22  | 1.23  | 1.23  | 1.20  | 1.20  | 1.20  | 1.20  | 1.20  | 1.20  | 1.20  |
| Population                           |       |                           |       |       |       |       |       |       |       |       |       |       |       |
| Population (million, eop)            | 45.63 | 45.59                     | 45.56 | 45.54 | 45.51 | 45.53 | 45.50 | 45.48 | 45.45 | 45.50 | 45.48 | 45.46 | 45.42 |
| Population (%YoY)                    | -0.3  | -0.3                      | -0.3  | -0.3  | -0.3  | -0.1  | -0.1  | -0.1  | -0.1  | -0.1  | -0.1  | -0.1  | -0.1  |

Notes: eop – end of period; cov. – coverage; con'd – consolidated; ann – annualised.

Sources: State Statistics Committee of Ukraine, National Bank of Ukraine, Investment Capital Ukraine LLC.

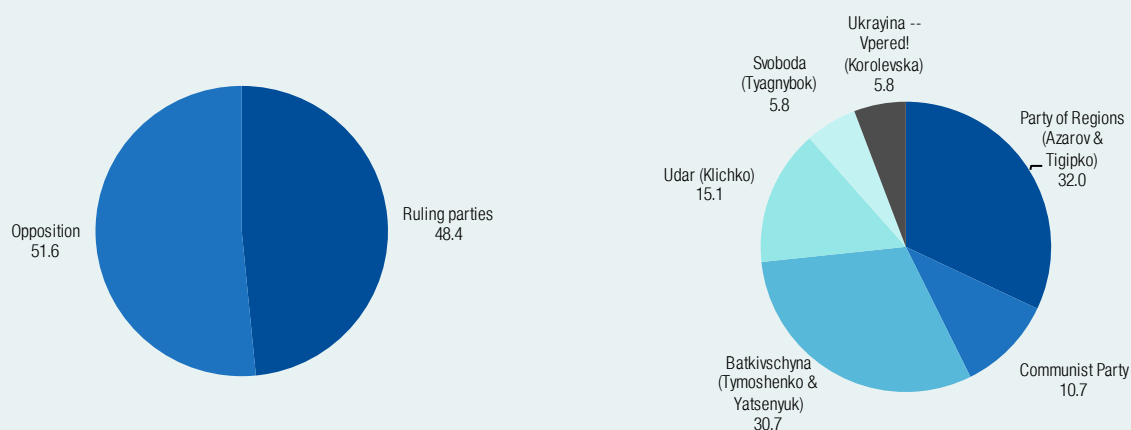
## **Appendices: Thematic charts & tables**

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

## Ukraine's political map after October 2012 (update)

This is an updated version of the parliamentary elections model, to determine the shape of political representation of the future parliament. The model was introduced and detailed in our previous issue of the *Quarterly Report* "Pinned again?" published in early April of this year. The main assumption of the model is that elections by party list will mirror the latest public opinion poll carried out by KIIS<sup>8</sup> over 2012 (as of the time of writing this report, the latest poll was as of the end of May). As for the overall election results, which comprise the elections by: 1) party lists; and 2) the individual elections in the regional constituencies, the main unknown variable is how much the results of the latter will differ from those of the former. As for the former—nationwide elections by party list—we assume that they will mirror the latest opinion poll. As for the latter—the individual elections in the regional constituencies—the election results depend on the nationwide opinion poll, and are adjusted for a "crowd out" ratio (ranging from 0-100%), which indicates the level of political or administrative advantage the representative of the ruling party will have over the representative of the opposition party.

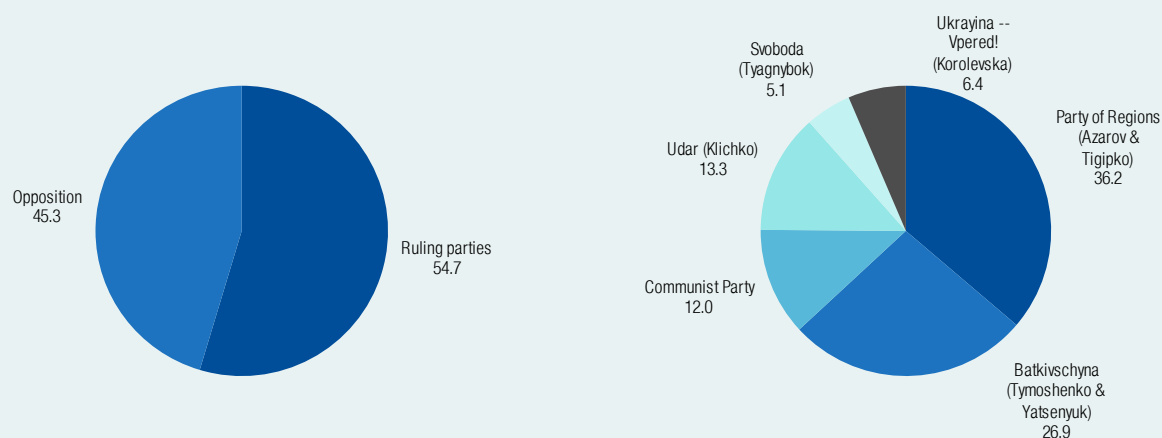
**Chart 18. Assumption #1: the crowd out ratio at 0%, probability rate 0%.** Breakdown of parliament by parties and blocs, 100% = 450 MPs.



Source: Investment Capital Ukraine LLC.

Source: Investment Capital Ukraine LLC.

**Chart 19. Assumption #2: the crowd out ratio at 25%, probability rate 30%.** Breakdown of parliament by parties and blocs, 100% = 450 MPs.



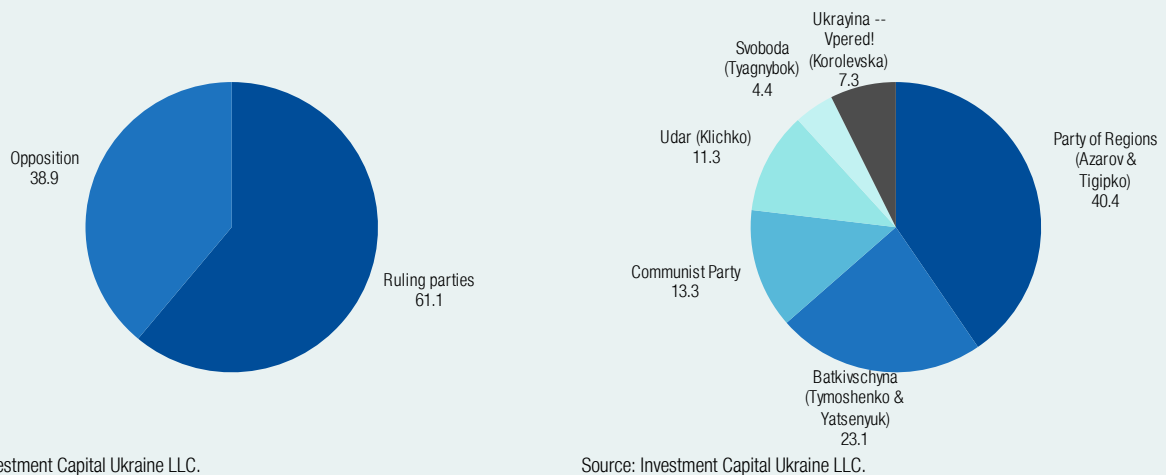
Source: Investment Capital Ukraine LLC.

Source: Investment Capital Ukraine LLC.

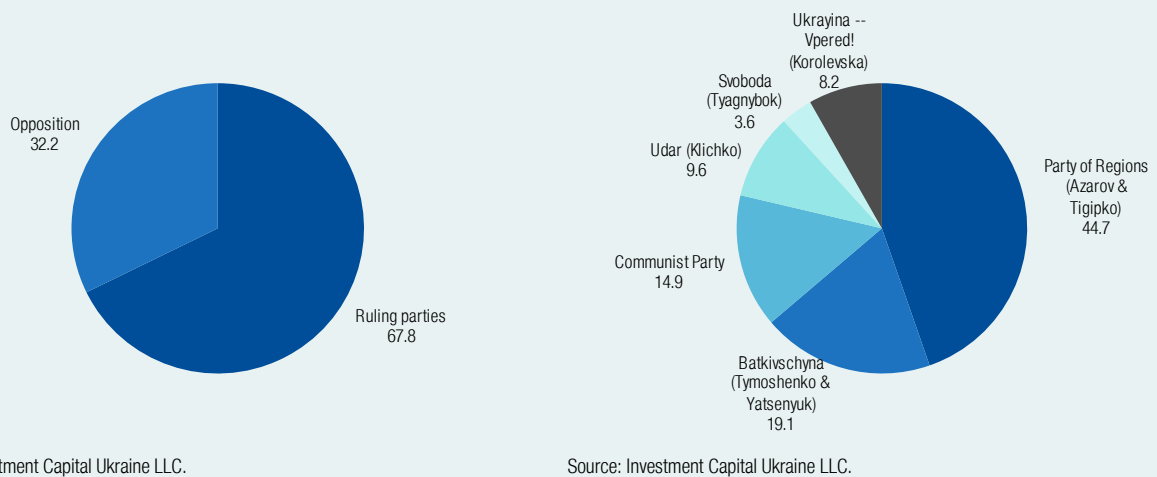
<sup>8</sup> Kiev International Institute for Sociology. See <http://kiis.com.ua/en/news/>.



**Chart 20. Assumption #3: the crowd out ratio at 50%, probability rate 50%.** Breakdown of parliament by parties and blocs, 100% = 450 MPs.



**Chart 21. Assumption #4: the crowd out ratio at 75%, probability rate 15%.** Breakdown of parliament by parties and blocs, 100% = 450 MPs.



**Chart 22. Assumption #3: the crowd out ratio at 100%, probability rate 5%.** Breakdown of parliament by parties and blocs, 100% = 450 MPs.

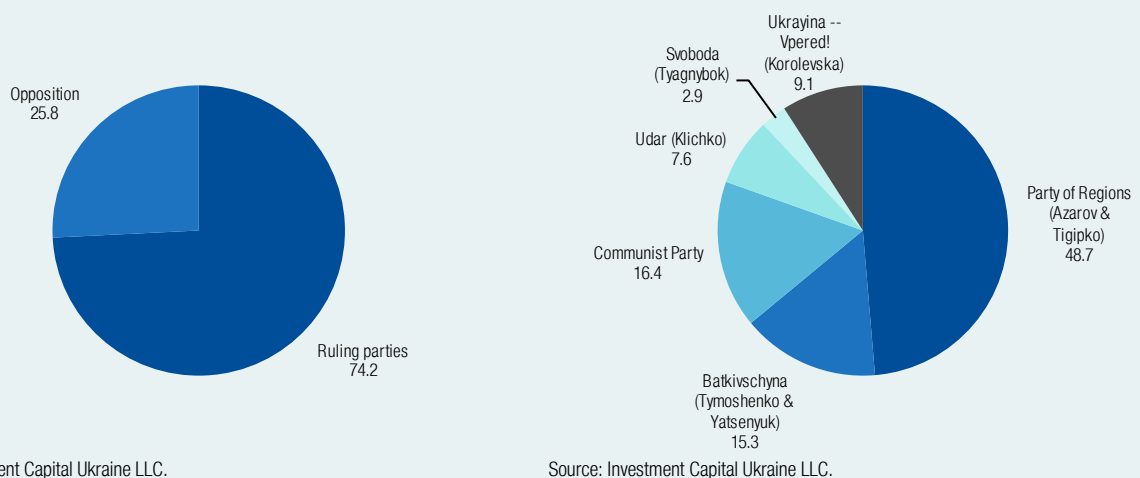


Table 5. The opinion polls by KIIS held in the period of October 2010-May 2012 and modelling of parliamentary election results upon the data of most latest poll

| Participation rate <sup>1</sup> (% of total)<br><br>Party or bloc of parties | Oct-10                           |                                       | Feb-11                           |                                       | Jun-11                           |                                       | Nov-11                           |                                       | Feb-12                           |                                       | Apr-12                           |                                       | May-12                           |                                       | Oct-12                           |                                       | Calculations of election results   |   |              |              |              |              |      |                 |          |  | WA<br>num-<br>ber of<br>seats | Current<br>number<br>of MPs |
|--|----------------------------------|---------------------------------------|----------------------------------|---------------------------------------|----------------------------------|---------------------------------------|----------------------------------|---------------------------------------|----------------------------------|---------------------------------------|----------------------------------|---------------------------------------|----------------------------------|---------------------------------------|----------------------------------|---------------------------------------|--|---|--------------|--------------|--------------|--------------|------|-----------------|----------|--|-------------------------------|-----------------------------|
|  | N/A                              |                                       | 53%                              |                                       | 54%                              |                                       | 53%                              |                                       | 63%                              |                                       | 55%                              |                                       | 55%                              |                                       | 60%                              |                                       | Share<br>of total<br>of seats<br>votes <sup>3</sup><br>by party<br>list <sup>4</sup> | Total numbers of seats: elected by<br>party lists and via constituencies<br>by crowd-out ratio (probability) <sup>5</sup> |              |              |              |              |      |                 |          |  |                               |                             |
|  | Share<br>of all<br>voters<br>(%) | Share of<br>voted <sup>2</sup><br>(%) | Share<br>of all<br>voters<br>(%) | Share of<br>voted <sup>2</sup><br>(%) | Share<br>of all<br>voters<br>(%) | Share of<br>voted <sup>2</sup><br>(%) | Share<br>of all<br>voters<br>(%) | Share of<br>voted <sup>2</sup><br>(%) | Share<br>of all<br>voters<br>(%) | Share of<br>voted <sup>2</sup><br>(%) | Share<br>of all<br>voters<br>(%) | Share of<br>voted <sup>2</sup><br>(%) | Share<br>of all<br>voters<br>(%) | Share of<br>voted <sup>2</sup><br>(%) | Share<br>of all<br>voters<br>(%) | Share of<br>voted <sup>2</sup><br>(%) |  | 0%<br>(0%)  | 25%<br>(30%) | 50%<br>(50%) | 75%<br>(15%) | 100%<br>(5%) |      |                 |          |  |                               |                             |
|  |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |  |   |              |              |              |              |      |                 |          |  |                               |                             |
| Party of Regions (Azarov & Tigipko)  | 28.5                             | 42.5                                  | 16.8                             | 31.9                                  | 13.5                             | 24.8                                  | 12.5                             | 23.8                                  | 16.5                             | 26.3                                  | 15.6                             | 28.2                                  | 15.1                             | 27.7                                  | 24.0                             | 28.2                                  | 31.9   | 72  | 144          | 163          | 182          | 201          | 219  | 179             | 192      |  |                               |                             |
| Strong Ukraine (Tigipko)   | 8.1                              | 12.1                                  | 3.3                              | 6.3                                   | 4.3                              | 7.9                                   | 3.2                              | 6.1                                   | 3.6                              | 5.8                                   |                                  |                                       |                                  |                                       |                                  |                                       |  |   |              |              |              |              |      | No seats        |          |  |                               |                             |
| Batkivschyna (Tymoshenko & Yatsenyuk)  | 9.9                              | 14.8                                  | 10.4                             | 19.7                                  | 10.9                             | 20.1                                  | 10.2                             | 19.3                                  | 14.0                             | 22.3                                  | 15.9                             | 28.6                                  | 14.4                             | 26.3                                  | 23.0                             | 27.1                                  | 30.5   | 69  | 138          | 121          | 104          | 86           | 69   | 107             | 100      |  |                               |                             |
| Front Zmin (Yatsenyuk)   | 5.3                              | 7.9                                   | 6.5                              | 12.4                                  | 7.7                              | 14.1                                  | 7.0                              | 13.4                                  | 7.9                              | 12.6                                  |                                  |                                       |                                  |                                       |                                  |                                       |  |   |              |              |              |              |      | No<br>seat<br>s |          |  |                               |                             |
| Communist Party  | 3.4                              | 5.1                                   | 3.3                              | 6.3                                   | 4.0                              | 7.3                                   | 5.1                              | 9.6                                   | 5.7                              | 9.0                                   | 4.7                              | 8.5                                   | 5.4                              | 9.8                                   | 8.0                              | 9.4                                   | 10.6   | 24  | 48           | 54           | 60           | 67           | 74   | 59              | 25       |  |                               |                             |
| Udar (Klichko)   | 2.3                              | 3.4                                   | 1.6                              | 3.0                                   | 3.1                              | 5.7                                   | 4.4                              | 8.4                                   | 4.6                              | 7.3                                   | 5.9                              | 10.6                                  | 8.4                              | 15.5                                  | 11.5                             | 13.5                                  | 15.3   | 34  | 68           | 60           | 51           | 43           | 34   | 53              | No seats |  |                               |                             |
| Svoboda (Tyagnybok)  | 2.6                              | 3.8                                   | 3.1                              | 5.9                                   | 2.5                              | 4.7                                   | 2.3                              | 4.4                                   | 3.4                              | 5.5                                   | 2.8                              | 5.1                                   | 2.8                              | 5.1                                   | 4.5                              | 5.3                                   | 6.0  | 13  | 26           | 23           | 20           | 16           | 13   | 20              | No seats |  |                               |                             |
| Ukrayina -- Vpered! (Korolevska)   |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       | 2.3                              | 4.1                                   | 2.6                              | 4.8                                   | 4.3                              | 5.1                                   | 5.7  | 13  | 26           | 29           | 33           | 37           | 41   | 32              | No seats |  |                               |                             |
| Civil position (Hrytsenko)   | 0.8                              | 1.2                                   | 1.2                              | 2.3                                   | 1.2                              | 2.2                                   | 1.1                              | 2.1                                   | 1.9                              | 3.0                                   | 1.7                              | 3.1                                   | 1.0                              | 1.9                                   | 1.7                              | 2.0                                   |  |   |              |              |              |              |      |                 |          |  |                               |                             |
| Other party/bloc   | 4.0                              | 9.2                                   | 4.2                              | 7.9                                   | 5.1                              | 5.9                                   | 4.5                              | 8.6                                   | 5.1                              | 8.2                                   | 6.6                              | 11.8                                  | 5.0                              | 8.9                                   | 8.0                              | 9.4                                   |  |   |              |              |              |              |      |                 |          |  |                               |                             |
| Against all  | 9.9                              |                                       | 17.6                             | 4.3                                   | 17.1                             | 4.1                                   | 18.0                             | 4.3                                   | X                                | X                                     | X                                | X                                     | X                                | X                                     |                                  |                                       |  |   |              |              |              |              |      |                 |          |  |                               |                             |
| Will not vote  | 10.0                             |                                       | 14.7                             |                                       | 14.8                             |                                       | 14.3                             |                                       | 16.1                             |                                       | 19.8                             |                                       | 18.1                             |                                       | 15.0                             |                                       |  |   |              |              |              |              |      |                 |          |  |                               |                             |
| Difficult to say   | 15.2                             |                                       | 17.3                             |                                       | 15.8                             |                                       | 17.4                             |                                       | 21.2                             |                                       | 24.7                             |                                       | 27.2                             |                                       |                                  |                                       |  |   |              |              |              |              |      |                 |          |  |                               |                             |
| TOTAL  | 100.0                            | 100.0                                 | 100.0                            | 100.0                                 | 100.0                            | 100.0                                 | 100.0                            | 100.0                                 | 100.0                            | 100.0                                 | 100.0                            | 100.0                                 | 100.0                            | 100.0                                 | 100.0                            | 100.0                                 | 100.0  | 225   | 450          | 450          | 450          | 450          | 450  | 450             |          |  |                               |                             |
| By number of seats   |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |  |   |              |              |              |              |      |                 |          |  |                               |                             |
| Ruling parties and blocs   |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |  | 109   | 218          | 246          | 275          | 305          | 334  | 270             |          |  |                               |                             |
| Opposition parties and blocs   |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |  | 116   | 232          | 204          | 175          | 145          | 116  | 180             |          |  |                               |                             |
| By share of total (%)  |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |  |   |              |              |              |              |      |                 |          |  |                               |                             |
| Ruling parties and blocs   |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |  | 48.4  | 48.4         | 54.7         | 61.1         | 67.8         | 74.2 | 60.0            |          |  |                               |                             |
| Opposition parties and blocs   |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |                                  |                                       |  | 51.6  | 51.6         | 45.3         | 38.9         | 32.2         | 25.8 | 40.0            |          |  |                               |                             |

Notes: [1] Participation rated as of date of poll that is the share of those who was going to take in the elections; [2] share of votes by those who was going to take part in the elections; [3] share of votes gained the parties and blocs that pass through the 5% election threshold; [4] number of seats the party or bloc gain through the election by party list; [5] total number of seats the party or bloc receives after the elections, it is a sum of number of seats gained through the election by party list and a number of seats gained through the elections in the constituencies, the latter figure is calculated upon the ratio of seats that incumbent ruling parties will win from the opposition parties; the ratio has five assumptions – from 0% to 100%; 0% means that incumbent ruling parties and opposition parties are gaining seats in the parliament in the exactly the same proportion as from the election by party list; 100% means that incumbent ruling parties would totally defeat the opposition parties in the constituencies and gain all the seats there;

[6] Ruling parties and blocs are consist of Party of Regions, Strong Ukraine and Communist Party; [7] weighted-average number seats calculated upon three assumptions, which have crowd-out ratio at 25%, 50% and 75, data weighted by probability ratio.

X means that since December 2011 the law on the parliamentary elections does not provide a possibility for a voter to cast her/his vote against all listed parties and blocs;

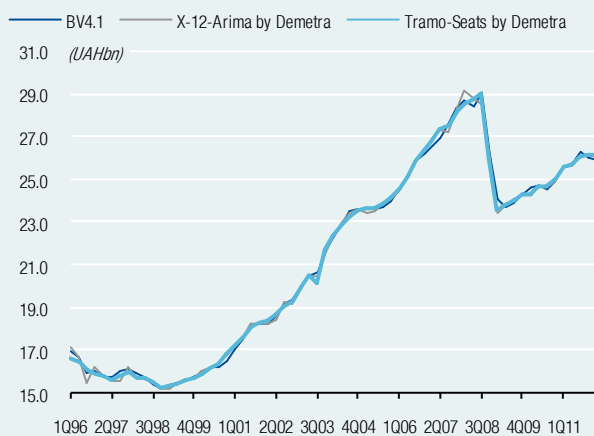
Sources: KIIS, Investment Capital Ukraine LLC.

## Quarterly GDP: Reported statistics and ICU's calculations

**Chart 23. Ukraine's economy from the perspective of quarterly GDP volumes (left) and on-quarter growth rates (right)**

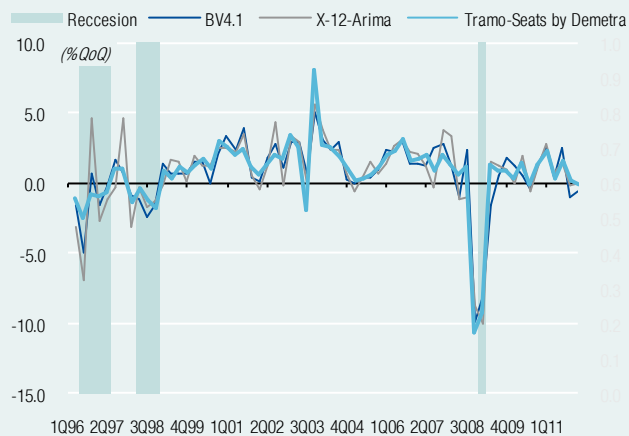
History from 1Q96 till 1Q12. Data is adjusted for inflation and seasonal factors

Quarterly GDP size in constant prices of Dec-95, data is seasonally adjusted by three methods BV4.1, X-12 Arima and Tramo-Seats



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

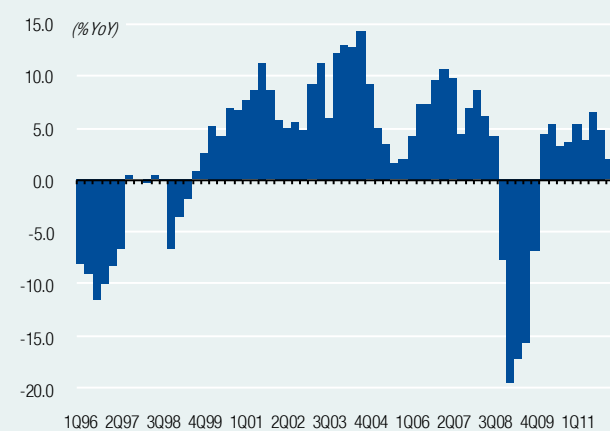
Quarterly GDP growth rates (% QoQ), data is seasonally adjusted by three methods BV4.1, X-12 Arima and Tramo-Seats



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

**Chart 24. Reported on-year quarterly GDP growth (% YoY)**

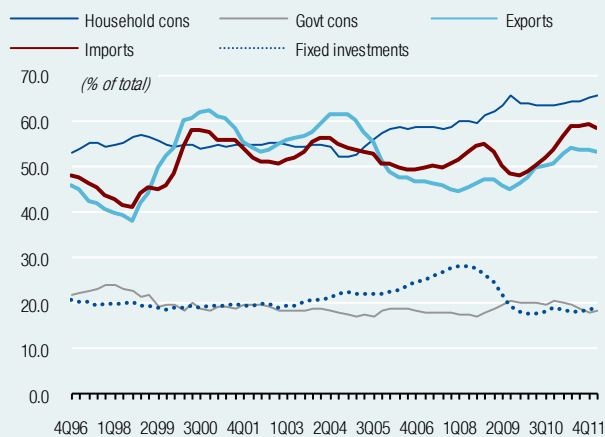
History from 1Q 1996 till 1Q 2012



Source: State Statistics Committee of Ukraine.

**Chart 25. Breakdown of GDP by key components from expenditure side (% of total, data for the last 12-month period)**

History from 4Q 1996 till 1Q 2012



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

**Table 6. Ukraine quarterly GDP size: History from 4Q96 till 4Q11 (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 current prices (UAHm)         | Real growth (%) YoY, qtlly | Real growth (%) QoQ, SA) | Deflator (%) YoY) | Real GDP at cons prices <sup>1</sup> (UAHm, NSA) | GDP at cons prices <sup>1</sup> (UAHm, SA) |                       |                        | Real GDP growth (%QoQ, SA) |                       |                        |       |
|        |                                      |                            |                          |                   |  | 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                                     | 16,006                | 16,228                 | 15,918                     | 0.9                   | 4.6                    | -0.8  |
| 1Q97   | 18,728                               | -8.3                       |                          | 22.3              | -9.8   | 14,114                                     | 15,779                | 15,780                 | 15,779                     | -1.4                  | -2.8                   | -0.9  |
| 2Q97   | 20,485                               | -6.6                       |                          | 22.7              | -9.1   | 14,117                                     | 15,723                | 15,586                 | 15,659                     | -0.3                  | -1.2                   | -0.8  |
| 3Q97   | 26,076                               | 0.5                        |                          | 15.3              | -6.2   | 17,544                                     | 15,968                | 15,531                 | 15,815                     | 1.6                   | -0.4                   | 1.0   |
| 4Q97   | 28,076                               | 0.0                        |                          | 14.8              | -3.7   | 17,405                                     | 16,073                | 16,258                 | 15,974                     | 0.7                   | 4.7                    | 1.0   |
| 1Q98   | 20,871                               | -0.3                       |                          | 11.8              | -1.6   | 14,068                                     | 15,941                | 15,744                 | 15,744                     | -0.8                  | -3.2                   | -1.4  |
| 2Q98   | 23,367                               | 0.5                        |                          | 13.5              | 0.2  | 14,188                                     | 15,764                | 15,701                 | 15,693                     | -1.1                  | -0.3                   | -0.3  |
| 3Q98   | 28,908                               | -0.1                       |                          | 10.9              | 0.0  | 17,538                                     | 15,431                | 15,435                 | 15,498                     | -2.1                  | -1.7                   | -1.2  |
| 4Q98   | 29,447                               | -6.6                       |                          | 12.3              | -1.7   | 16,256                                     | 15,157                | 15,236                 | 15,221                     | -1.8                  | -1.3                   | -1.8  |
| ...    | ...                                  | ...                        | ...                      | ...               | ...  | ...  | ...                   | ...                    | ...                        | ...                   | ...                    | ...   |
| 1Q04   | 66,981                               | 12.9                       |                          | 12.8              | 10.5   | 20,030                                     | 22,260                | 22,406                 | 22,284                     | 3.0                   | 3.7                    | 2.5   |
| 2Q04   | 78,607                               | 12.7                       |                          | 14.8              | 10.9   | 20,773                                     | 22,864                | 22,923                 | 22,895                     | 2.7                   | 2.3                    | 2.7   |
| 3Q04   | 99,405                               | 14.3                       |                          | 14.7              | 13.0   | 26,909                                     | 23,530                | 23,455                 | 23,332                     | 2.9                   | 2.3                    | 1.9   |
| 4Q04   | 100,120                              | 9.1                        |                          | 17.4              | 12.2   | 24,800                                     | 23,572                | 23,617                 | 23,572                     | 0.2                   | 0.7                    | 1.0   |
| 1Q05   | 88,104                               | 5.0                        |                          | 25.3              | 10.2   | 21,027                                     | 23,598                | 23,474                 | 23,647                     | 0.1                   | -0.6                   | 0.3   |
| 2Q05   | 101,707                              | 3.5                        |                          | 25.1              | 7.9  | 21,484                                     | 23,638                | 23,568                 | 23,678                     | 0.2                   | 0.4                    | 0.1   |
| 3Q05   | 122,861                              | 1.5                        |                          | 21.8              | 4.7  | 27,306                                     | 23,789                | 23,925                 | 23,804                     | 0.6                   | 1.5                    | 0.5   |
| 4Q05   | 128,780                              | 1.9                        |                          | 26.3              | 3.0  | 25,257                                     | 24,027                | 24,093                 | 24,109                     | 1.0                   | 0.7                    | 1.3   |
| 1Q06   | 106,348                              | 4.3                        |                          | 15.7              | 2.8  | 21,937                                     | 24,553                | 24,426                 | 24,571                     | 2.2                   | 1.4                    | 1.9   |
| 2Q06   | 126,319                              | 7.2                        |                          | 15.9              | 3.7  | 23,023                                     | 25,129                | 25,078                 | 25,141                     | 2.3                   | 2.7                    | 2.3   |
| 3Q06   | 152,406                              | 7.3                        |                          | 15.6              | 5.2  | 29,301                                     | 25,870                | 25,847                 | 25,929                     | 2.9                   | 3.1                    | 3.1   |
| 4Q06   | 159,080                              | 9.6                        |                          | 12.8              | 7.1  | 27,659                                     | 26,289                | 26,419                 | 26,351                     | 1.6                   | 2.2                    | 1.6   |
| 1Q07   | 139,444                              | 10.6                       |                          | 18.6              | 8.7  | 24,253                                     | 26,665                | 26,929                 | 26,803                     | 1.4                   | 1.9                    | 1.7   |
| 2Q07   | 166,869                              | 9.7                        |                          | 20.4              | 9.3  | 25,260                                     | 26,945                | 27,304                 | 27,326                     | 1.1                   | 1.4                    | 2.0   |
| 3Q07   | 199,535                              | 4.4                        |                          | 25.4              | 8.5  | 30,592                                     | 27,589                | 27,196                 | 27,593                     | 2.4                   | -0.4                   | 1.0   |
| 4Q07   | 214,883                              | 6.9                        |                          | 26.4              | 7.9  | 29,558                                     | 28,327                | 28,250                 | 28,145                     | 2.7                   | 3.9                    | 2.0   |
| 1Q08   | 191,459                              | 8.5                        |                          | 26.6              | 7.4  | 26,303                                     | 28,645                | 29,125                 | 28,482                     | 1.1                   | 3.1                    | 1.2   |
| 2Q08   | 236,033                              | 6.2                        |                          | 33.2              | 6.5  | 26,824                                     | 28,351                | 28,825                 | 28,702                     | -1.0                  | -1.0                   | 0.8   |
| 3Q08   | 276,451                              | 4.3                        |                          | 32.9              | 6.5  | 31,892                                     | 28,988                | 28,511                 | 29,030                     | 2.2                   | -1.1                   | 1.1   |
| 4Q08   | 244,113                              | -7.8                       |                          | 23.3              | 2.6  | 27,233                                     | 26,192                | 26,052                 | 25,965                     | -9.6                  | -8.6                   | -10.6 |
| 1Q09   | 189,028                              | -19.6                      |                          | 22.8              | -4.8   | 21,148                                     | 24,040                | 23,364                 | 23,541                     | -8.2                  | -10.3                  | -9.3  |
| 2Q09   | 214,103                              | -17.3                      |                          | 9.7               | -10.6  | 22,181                                     | 23,652                | 23,769                 | 23,826                     | -1.6                  | 1.7                    | 1.2   |
| 3Q09   | 250,306                              | -15.7                      |                          | 7.4               | -15.2  | 26,886                                     | 23,859                | 24,070                 | 24,072                     | 0.9                   | 1.3                    | 1.0   |
| 4Q09   | 259,908                              | -6.7                       |                          | 14.1              | -15.0  | 25,412                                     | 24,335                | 24,363                 | 24,336                     | 2.0                   | 1.2                    | 1.1   |
| 1Q10   | 219,428                              | 4.8                        |                          | 10.7              | -9.1   | 22,176                                     | 24,781                | 24,465                 | 24,539                     | 1.8                   | 0.4                    | 0.8   |
| 2Q10   | 260,150                              | 5.5                        |                          | 15.1              | -3.4   | 23,415                                     | 24,973                | 25,073                 | 24,945                     | 0.8                   | 2.5                    | 1.7   |
| 3Q10   | 304,709                              | 3.6                        |                          | 17.5              | 1.7  | 27,855                                     | 24,881                | 24,905                 | 24,952                     | -0.4                  | -0.7                   | 0.0   |
| 4Q10   | 310,320                              | 3.3                        | 0.7                      | 15.6              | 4.3  | 26,247                                     | 25,253                | 25,230                 | 25,328                     | 1.5                   | 1.3                    | 1.5   |
| 1Q11   | 263,550                              | 5.3                        | 1.4                      | 14.1              | 4.4  | 23,344                                     | 25,723                | 25,734                 | 25,721                     | 1.9                   | 2.0                    | 1.6   |
| 2Q11   | 316,480                              | 3.8                        | 0.4                      | 17.2              | 4.0  | 24,305                                     | 25,895                | 26,038                 | 25,965                     | 0.7                   | 1.2                    | 1.0   |
| 3Q11   | 387,970                              | 6.6                        | 0.7                      | 19.5              | 4.7  | 29,679                                     | 26,704                | 26,477                 | 26,529                     | 3.1                   | 1.7                    | 2.2   |
| 4Q11   | 363,948                              | 4.6                        | 2.9                      | 12.1              | 5.1  | 27,454                                     | 26,663                | 26,575                 | 26,767                     | -0.2                  | 0.4                    | 0.9   |

Notes: [1] at constant prices of December 1995; SA – seasonally adjusted data; NSA --- non seasonally adjusted data.

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

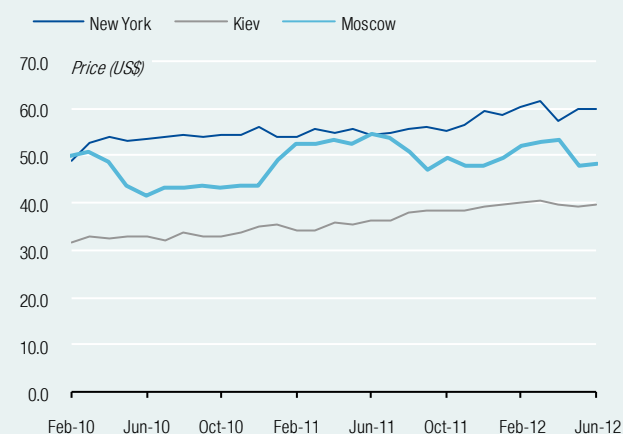
## ICU consumer basket: Observation of Kiev, New-York and Moscow prices

**Table 7. ICU consumer basket as of end of June 2012**

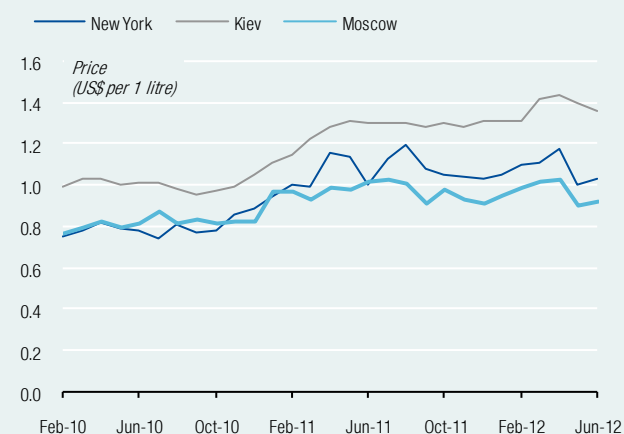
price observation in the urban areas of Ukraine, USA and Russia, i.e., in the countries' most populated cities – Kiev, New-York, and Moscow

| Item of the basket  | Description   | Kiev,<br>central<br>district<br>30-Jun-12<br>Price (UAH) | New York<br>metropol-<br>itan area<br>1-Jul-12<br>Price (US\$) | Moscow,<br>central<br>district<br>30-Jun-12<br>Price (RUR) |
|---|---|--|--|--|
| <b>Consumer goods</b>   |   |  |  |  |
| Coca-cola (0.5 liter, plastic bottle)                                   | Non-alcohol beverages   | 6.27   | 0.68   | 39.90  |
| Beer Stella Artois (0.33 litre, glass bottle)                           | Alcoholic beverages   | 7.02   | 1.67   | 47.90  |
| Bunch of fresh bananas (1 kg)   | From Ecuador  | 10.99  | 1.52   | 40.90  |
| Pack of milk (1 liter)  | Locally produced, soft package, i.e., not glass bottle                          | 8.37   | 2.03   | 59.90  |
| Chicken meat (1 kg pack)  | Locally produced and branded package, boneless breast                           | 47.99  | 12.77  | 159.00   |
| Canned pineapple (0.85 kg, can)   | Pineapple circles, Dole brand   | 22.26  | 1.50   | 129.00   |
| Pasta (0.5 kg)  | Soft package, produced in Italy   | 18.54  | 2.12   | 62.90  |
| Sugar (1 kg)  |   | 7.77   | 3.18   | 39.90  |
| Package of table salt (0.5 kg)  |   | 9.79   | 0.53   | 17.90  |
| Chicken eggs (10 units pack)  | White eggs, standard size   | 12.36  | 2.60   | 49.88  |
| Chocolate (100 g)   | Made by Craft Foods Corp, Milka brand   | 11.44  | 2.15   | 62.90  |
| Toothpaste (100ml package)  | Colgate   | 22.98  | 2.40   | 91.90  |
| Shampoo (200ml package)   | Head & Shoulders brand, for normal hair   | 29.31  | 3.11   | 159.00   |
| Toilet paper (4 rolls package)  | Kleenex Cottonelle brand, white paper, Regular toilet tissue                    | 18.78  | 4.32   | 79.00  |
| Magazine  | Men's Health, local edition, A4 format (standard one, not a pocket book format) | 26.89  | 4.99   | 119.00   |
| Gasoline (1 liter)  | Lukoil, regular   | 10.95  | 1.03   | 29.97  |
| <b>Services</b>   |   |  |  |  |
| Underground commute ticket  | Within the central part of the city   | 2.00   | 2.25   | 28.00  |
| Cinema ticket   | Thursday's night price for the seat with good location, Hollywood film          | 45.00  | 11.25  | 350.00   |
| <b>Total basket value (in local currency)</b>                           |   | 318.71   | 60.10  | 1,566.95   |
| Exchange rate versus US dollar at spot market as of date of observation |   | 8.026  | 8.059  | 1.000  |
| <b>Total basket value (in US\$)</b>                                     |   | <b>39.55</b>   | <b>60.10</b>   | <b>48.33</b>   |
| <b>Overvalued "+" / undervalued "-" (%)</b>                             |   |  |  |  |
| UAH vs USD  |   | <b>-34.19</b>  |  |  |
| UAH vs RUR  |   | <b>-18.16</b>  |  |  |
| <b>Fair value in the long-run as of observation date</b>                |   |  |  |  |
| UAH per USD   |   | <b>5.303</b>   |  |  |
| UAH per RUR   |   | <b>0.203</b>   |  |  |

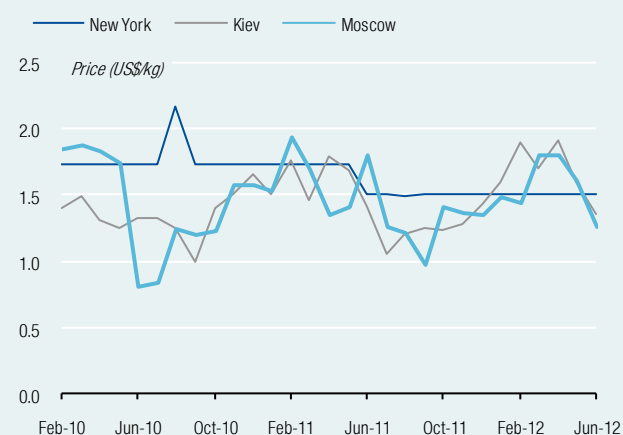
Source: Investment Capital Ukraine.

**Chart 26. ICU consumer basket value (US\$), from Feb-10 till Jun-12***Total value of the ICU basket in US dollar terms*

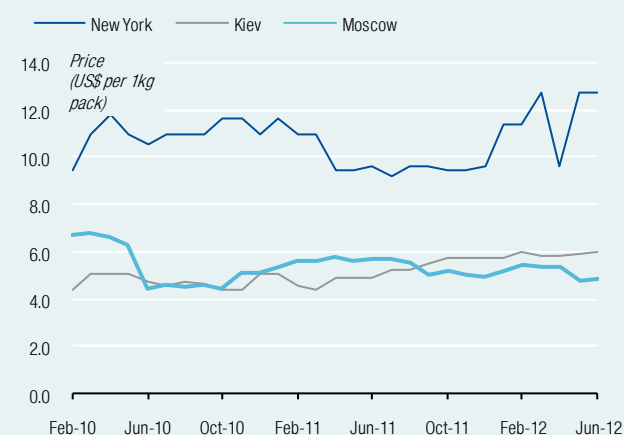
Source: Investment Capital Ukraine.

**Chart 27. Gasoline A95 equivalent 1 litre (US\$)***Price history from February 2010 till June 2012*

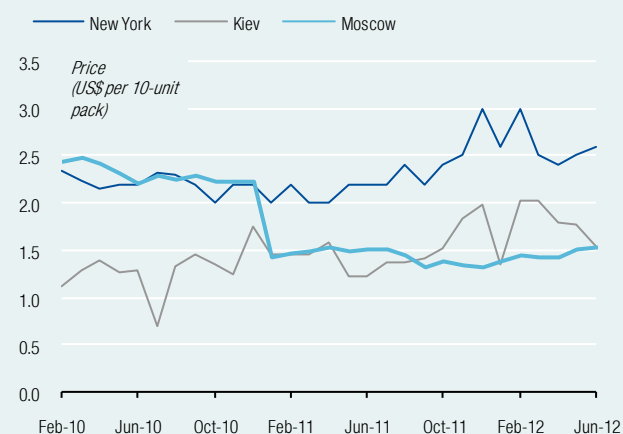
Source: State Statistics Committee of Ukraine.

**Chart 28. Fresh banana 1 kg bunch (US\$)***Price history from February 2010 till June 2012*

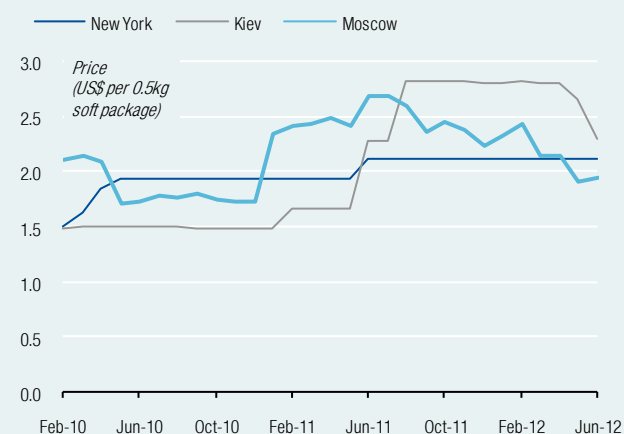
Source: Investment Capital Ukraine.

**Chart 29. Chicken meat 1 kg pack of boneless breast (US\$)***Price history from February 2010 till June 2012*

Source: State Statistics Committee of Ukraine.

**Chart 30. Chicken eggs 10-unit pack (US\$)***Price history from February 2010 till June 2012*

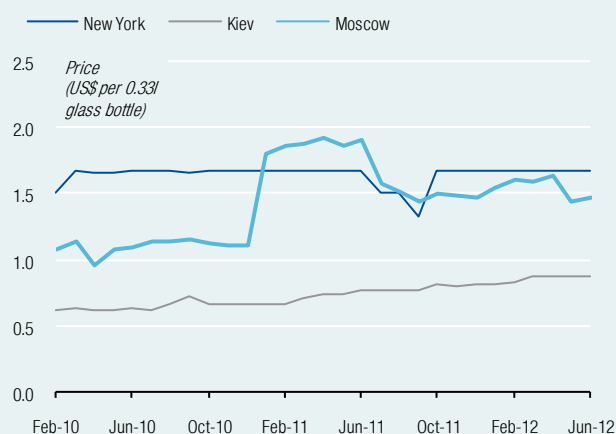
Source: Investment Capital Ukraine.

**Chart 31. Pasta 0.5 kg soft package Italy-made (US\$)***Price history from February 2010 till June 2012*

Source: Investment Capital Ukraine.

**Chart 32. Beer Stella Artois 0.33 litre glass bottle (US\$)**

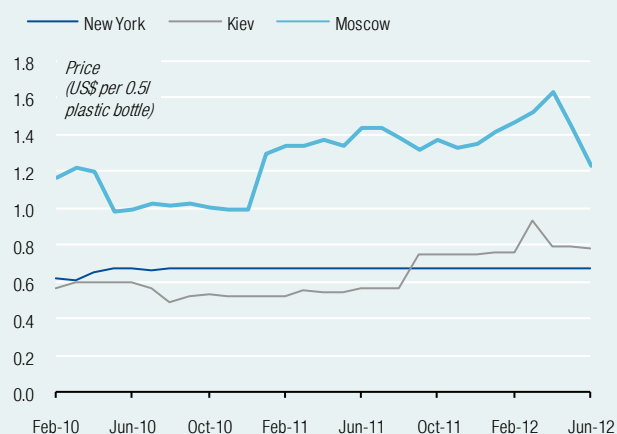
Price history from February 2010 till June 2012



Source: State Statistics Committee of Ukraine.

**Chart 33. Coca-Cola 0.5 litre plastic bottle (US\$)**

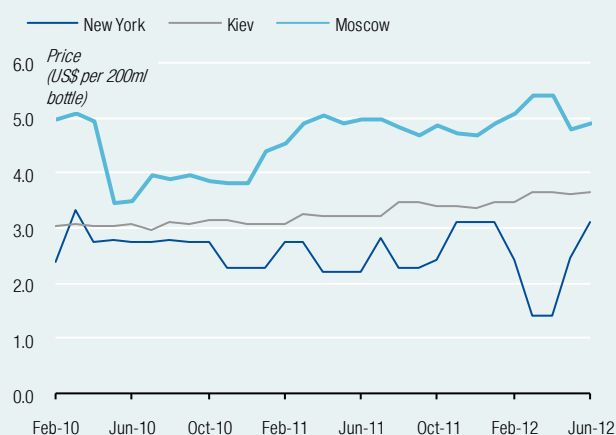
Price history from February 2010 till June 2012



Source: State Statistics Committee of Ukraine.

**Chart 34. Shampoo 200ml bottle Head & Shoulders (US\$)**

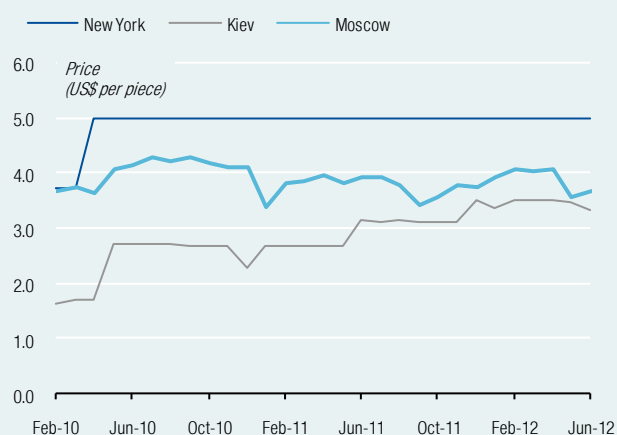
Price history from February 2010 till June 2012



Source: State Statistics Committee of Ukraine.

**Chart 35. Magazine *Men's Health*, A4 format (US\$)**

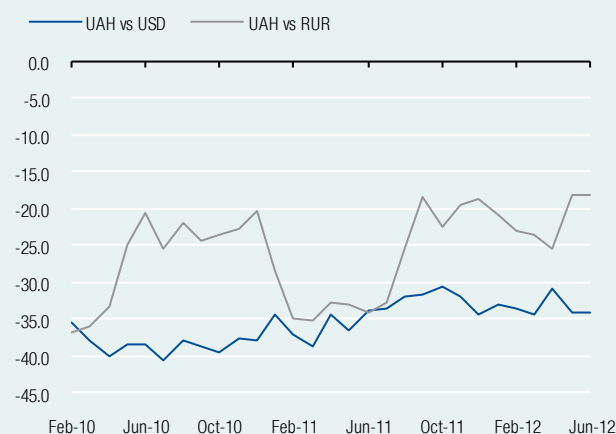
Price history from February 2010 till June 2012



Source: State Statistics Committee of Ukraine.

**Chart 36. Value gap of ICU basket in UAH vs USD and RUB (%)**

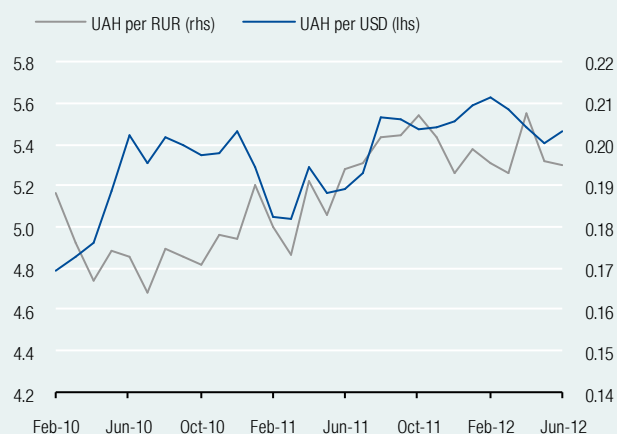
Price history from February 2010 till June 2012



Source: State Statistics Committee of Ukraine.

**Chart 37. 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 June 2012



Source: State Statistics Committee of Ukraine.









## Disclosures

### ANALYST CERTIFICATION

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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