UKRAINE:
Macro

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CONCORDE CAPITAL

Ukraine's Macro Economy

The First Half 2005

September 26, 2005

Content

Summary

Social Promises Instead Of Investments. The government’s efforts to pump extra funds to the budget in support of ambitious social programs destroyed the consumption/investment balance in the economy. Additionally the uncertainty about the future, caused by the threat of re-privatization made many companies to postpone their investment projects and hurt foreign investor perceptions. As a result, all social obligations have been fulfilled in full while investments stagnate.

Inflation: Government Keeping Watch. Curbing inflation was and still is, a top priority for the government. Despite the increased social payments and a series of price crises (gasoline, sugar and meat), the government managed to keep inflation from running out of control, by combining monetary and administrative tools. The next test the government will have to pass – an increase in gas prices, expected this winter.

Social Budget Repeat Expected In 2006. Judging from the recent budgetary resolution, we will see another “consumption budget” in 2006, likely to entail the same macroeconomic risks as in the current one. Further consumption demand will be spurred by the increased social payments, which during the period of economic slowdown will not be absorbed in full, and threatens to unleash higher inflation.

Economy Stumbles. The sharp deceleration of Ukraine’s economic growth observed in the first quarter of 2005 continued in April-June. As a result, for the first six months of the year GDP growth rate was more than three times less than during the same period of 2004: 4.0% yoy vs. 12.7% yoy. Industry was negatively affected by external factors. Adverse price trends on the world steel markets negatively impacted Ukraine’s “industry engine” - metallurgy. On the cost side – dependency on Russia for energy is starting to put serious pressure on the economy, as Russia is ready to liberalize gas prices.

Export Surplus Evaporating. The fall in world steel prices undermined the potential of Ukraine’s metallurgy, the countries main export. Growth rates for metal exports were cut in half in 1H05 and negatively affected total export dynamics. Coupled with accelerating imports, this led to a six-fold decrease in the merchandise balance.

National Bank: Enough Room To Maneuver. Due to the positive current account balance in 1H05, the FX currency supply dominated over demand. This allowed the National Bank, through interventions, to enlarge its international reserves to a historical peak of USD13.1 bln. This amount provides the NBU enough flexibility, in particular in currency exchange policy. After April’s sharp Hryvnia appreciation, the NBU has kept UAH/USD exchange rate stable at 5.05. We assume there will be exchange rate fluctuation around the ~1% level during 2H05.

We Have Revised Our 2005 Estimates For Basic Macro Indicators:

GDP	from 7% to 5%
Industry growth	from 9.5% to 6.0%
CPI	unchanged at 13%
PPI	from 19% to 16%
FDI inflow	from USD 1,750 mln to USD 1,077 mln

Focusing On The Budget

2005 Budget: Execution

“Social” – the main feature of the budget-2005…

The new budget, amended by the Verkhovna Rada in March, featured substantial increases in expenditures and revenues: 20% and 23% respectively versus the previous budget adopted in December 2004. This was done to support the government’s ambitious social program promised by newly elected President Viktor Yushchenko during his election campaign. The total amount for social payments is estimated to be USD 6.3 bln higher than in 2004, which will accommodate:

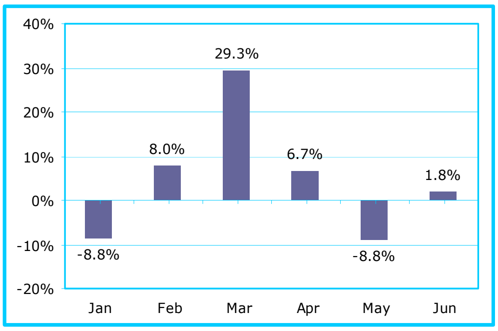
- 12.5% increase in the minimum pension to USD 65;
- 26.7% raise in the minimum wage to USD 65;
- 3 to 12 fold increase in other social benefits

For the first half of 2005 Ukraine’s consolidated budget revenues amounted to USD 11.5 bln, 52.2% more than for the same period in 2004, and 6.1% above the target. At the same time, budget expenditures increased by 49.8% to USD 11.1 bln. Semi-annual budget expenditures were 6.6% below the plan. These budget dynamics resulted in a 1H05 budget surplus of USD 363 mln or 1% of GDP, which will used by the end of the year for the following reasons:

- The execution of the 2005 privatization program is still questionable – 1H05 privatization receipts amounted to USD 135 mln, 10% of the annual plan

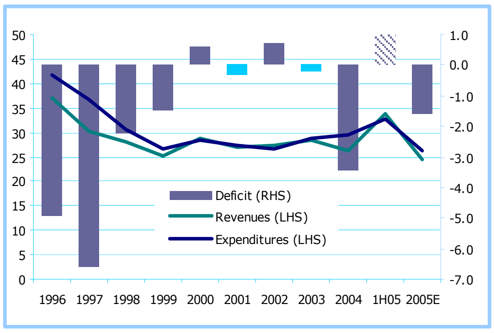
- The further increase of the minimum wage by 7% to USD 65 took place on September 1, 2005; in July the Rada approved amendments to the budget that envisaged the redemption of wage arrears (~USD 80 mln) in the coal-mining sector; the 2006 budget is also expected to have increased social components

Budget Cash Inflows, % To Plan In 1H2005



Source: State Treasury

Ukraine’s Budget Parameters, % Of GDP



Source: Finance Ministry

Budget targets over-performed so far…

The amended 2005 budget was based on a positive outlook for Ukrainian economic performance in 2005: GDP growth of 8.2%, Industry growth of 12.0% and annual inflation under 10%. However the drastic economic growth slow down observed in 2005 made the government’s macroeconomic forecast unrealistic. In addition, 1H05 revenues from privatization reached only 10% of the annual target figure (USD 1.35 bln). However, the following made it possible for the government to call its budget a success.

The reasons for budget success in 1H05:

Legislation

- The cancellation of preferential tax treatment for the Free Economic Zones (FEZ) and some industries (car-making, air-craft). The liquidation of a specific tax regime for FEZs alone may provide the budget with an additional ~USD 500 mln by the end of the year. This amount was lost on FEZs in 2004
- A rise in excise duties (alcohol and tobacco)
- On July 7, the Rada passed a law on changes to the 2005 state budget, which raised oil extraction royalties by 83% to USD 109

Macroeconomic

- The GDP structure has changed this year – imports have grown three times more than exports. That means operations that are subject to VAT tax (import) are growing faster than those taxed at a zero VAT rate and claim for VAT refund

- Higher than expected growth in consumer prices also facilitate the government to make additional revenues "out of a thin air" through increased price-included taxes (excise, import duties);

Higher Tax Collection

- During 1H05 the government managed to significantly improve tax collection. Thus receipts from VAT were 13% above the target, enterprise profits tax (EPT) collections were over-executed by 16% and receipts from import duties were 15% above what was expected.

  However this figure should be treated carefully. Over-execution of VAT was largely due to increased VAT refund arrears that have reached USD 600 mln since the beginning of the year. That means the state budget was filled partially through implicit domestic borrowing from the commercial sector. Additionally the ways in which the over-execution in EPT collection was reached also raise some concerns in their economic background: the size of "voluntary" overpayments of EPT grew by 82% during 1H05 and exceeded USD 500 mln.

The Privatization Plan – A Herculean Task?

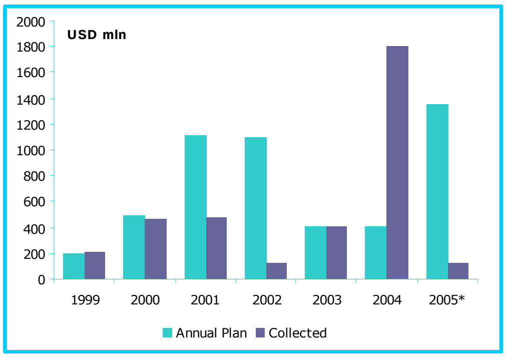
1H05 privatization receipts are lagging behind the plan…

In March when the Rada amended the State Budget for 2005, it set a target amount of USD 1.35 bln to be received from privatization this year. However, the results from the first half of 2005 show that privatization receipts only amount to USD 134 mln, about 10% of the annual plan. These poor privatization inflows can be explained by the lack of a clearly-cut government strategy as to privatization (the State Privatization Program for 2005 still has not been adopted). Additionally the re-privatization process, launched at the start of the year, was very cumbersome for the government due to the lack of proper legislation.

Re-privatization: the fog is lifting

The government's intensions to return a number of allegedly illegally privatized companies to state ownership and uncertainty as to the exact targets was one the main reasons for poor investment activity, both foreign and internal. During the summer the situation surrounding the re-privatization process became more or less clear. There are no more discussions about a massive privatization revision as there were at the start of the year, when some officials talked about the possibility of 3000 companies being subject to revision. On 2 September, President Yushchenko ordered the Cabinet and the Prosecutor General's Office to withdraw all lawsuits on the cancellation of privatization that the Ministry of Justice considered hopeless. Yushchenko decided to end the prolonged re-privatization fever that seriously damaged the interest foreign investors had in Ukraine. The government will most likely satisfy its re-privatization appetite with a couple of objects such as Kryvorizhstal, Nikopol Ferroalloy and some GOKs.

Privatization Receipts



Source: State Treasury
** collected in 1H05*

Kryvorizhstal case: may be resolved soon

In June the government managed to achieve a significant break-through in the Kryvorizhstal (KRST) case. On June 2, 2005 the Kyiv Court of Appeals rejected an appeal by the Investment Metallurgical Union (IMU), the previous owner, on the decision of Kyiv Economic Court from April 22, 2005 that recognized the privatization of a 93.02% stake in KRST as illegal. As a result on June 16, 2005 ING Bank (Ukraine) transferred 93.02% shares from IMU's account to the State Property Fund (SPF). In August the SPF announced a new privatization auction for the 93.02% stake on October 24, 2005 with a starting price of UAH 10 bln (~USD 2 bln). The SPF also intends to sell a 1.74% stake in KRST on the stock exchange in the period between September 30 and December 31, 2005.

A privatization list for 2005-06 has been adopted…

In order to revive the stalled privatization process the Cabinet lifted the ban on the privatization of strategic companies, that was introduced in January 2005. The Cabinet approved a list of 530 companies to be privatized in 2005-06. In order to meet the privatization plan for 2005, in July the Cabinet also adopted a list of 30 companies subject for immediate privatization this year. Among these companies are heavy-weights including:

- Kryvorizhstal (KRST)
- Ukrtelecom (UTEL), a monopoly fixed-line provider
- Kryviy Rih Iron Ore "Okyslennih Rud"
- Odesa Portside Plant, a major ammonia producer
- Nikopol Southern Pipe Works
- Azot Severodonetsk, a major chemical plant

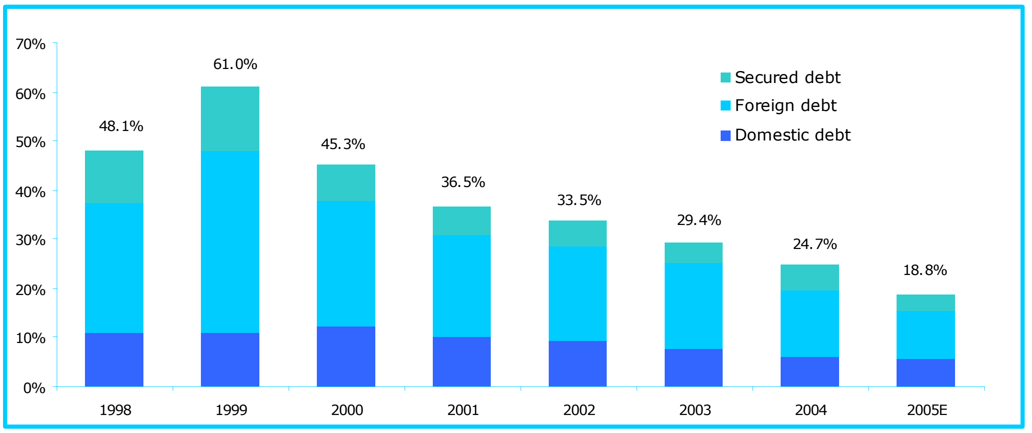
Debt Financing

The modest privatization revenues (for 1H05 they were only 10% of the annual plan), have forced the government to increase its reliance on new borrowings to finance increased budget expenditures. However, as the redemption volumes exceeded those of newly issued borrowing instruments, total public debt declined by 2.2% ytd to USD15.7 bln.

More domestic borrowings

The debt structure has also been changing. The government reduced the share of foreign debt, while issuing more government domestic bonds (OVDP). During the first half of the year foreign public debt fell by 6.3% while domestic debt increased by 12.2% ytd to USD 4.43 bln. During 1H05 the government issued about USD 1.3 bln in domestic bonds, exceeding the ceiling of annual borrowing set in the budget. According to the amended Budget Law for 2005 borrowing on foreign and domestic markets is set at USD 0.63 bln and USD 1.2 bln respectively. However the government has the right to go beyond this limit if the attracted funds are directed to a pre-term repurchase of more expensive previous obligations due to the National Bank.

Ukraine's Debt Breakdown, % Of GDP

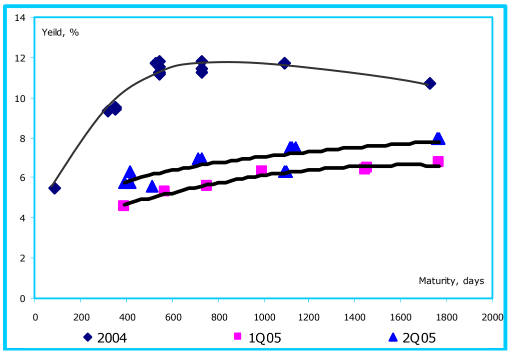


Source: the Finance Ministry

Domestic bonds are in high demand with foreign investors

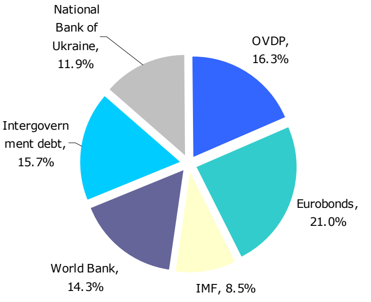
Government bonds issued in 2005 turned out to be an attractive debt instrument for non-residents who bought ~40% of the government bonds at initial auctions. Such high demand from foreign investors allowed the government to significantly reduce the cost of the borrowings and increase maturity terms. At the same time there is a risk the local fixed income market may be vulnerable to changes in sentiment by foreign investors. Although currently there have been no signs of foreign capital outflow, in June the National Bank banned non-residents from buying government bonds with maturity under one year.

Government Bond Issues In 2004-05



Source: Finance Ministry

Ukraine's Debt Structure In 1H05



Source: Finance Ministry

Yields are going up

Since June yield rates on government bonds during initial placements noticeably increased. While in March 5-year bonds were placed at 6.74%, on June 30 the Finance Ministry placed the new bonds with the same maturity levels at 8.0%. The poor receipts from privatization and hence the need to make state bonds more attractive for local investors, as well as higher than expected inflation rates, were the main reasons for the upward shift of the yield curve.

A new Eurobond issue is in the pipeline

Despite the government’s initial intensions to draw funds from domestic borrowings, in August, the Finance Ministry announced it is going to enter the European capital market with a EUR 600 mln Eurobond issuance scheduled for October 2005. The last Eurobond issue Ukraine made was last year, when it placed USD 500 mln for five years at a float rate of LIBOR + 3.375% and USD 600 mln for seven years at 6.875%. The Eurobonds with a 10-year tenor are expected to be placed at 5-6% rate. The attracted funds will be used to finance the increasing budget expenditures in 2H05. The Eurobonds are noticeably cheaper even with underwriting costs than borrowing on the local market. The Finance Ministry intends to make the placement at 5-6% for 10 years while 5-year domestic bonds were placed during the last auction at 8.0%.

Budget-2006: Another "Consumption" Budget

Budget repeat…

On June 21, 2005 the Rada adopted the Budget Resolution for 2006, which establishes major budgetary guidelines for the coming fiscal year. The resolution envisages that the 2006 Budget revenues and expenditures ratio to GDP will remain almost at the level forecasted in the 2005 Budget. It also sets the ceiling for fiscal deficit at 2% of GDP and that of the state debt at 22% of GDP. The major budget indicators envisaged in the resolution, are based on a forecast of a 7.0% yoy real GDP growth in 2006. This assumption looks rather optimistic, taking into account the current economic slowdown – this year it is doubtful GDP any higher than 5%.

Key Budget Comparisons

Indicators	Budget-2005	Resolution-2006
Revenues, % to GDP	*24.3*	*24.1+*
Expenditures, % to GDP	*26.1*	*26.1+*
Deficit, % to GDP	*1.8*	2.0-
Debt/GDP	*19.6*	*22.0-*
Real GDP growth %	8.0	7.0
CPI, %	9.8	9.8

Source: Finance Ministry

The social component will continue to grow…

The resolution foresees a further increase in social expenditures. In particular, it is envisaged that the minimum wage will further increase to USD 78 (from USD 65 scheduled for September 2005) and that the subsistence minimum will rise to USD 100 (from the current USD 83). Consequently, the size of the minimal pension, which is linked to the subsistence minimum, will also go up.

One distinctive feature of the adopted resolution is that it sets guidelines for fiscal policy not only in 2006, but also for several years ahead. This can be treated as a positive step towards medium-term budget planning, a common practice in most countries, that provides more certainty about the future fiscal environment. However, the resolution does not include any time schedules for the execution of the government's fiscal plans. This allows the government a high level of discretion, since any of the planned long-term tasks could be postponed at any time.

Another "consumption budget"…

Although the provisions of budgetary resolutions often appeared non-binding during the State Budget preparation process and its approval, it can be said with a high level of certainty that the 2006 budget will be another "consumption budget." It is likely to entail the same macroeconomic risks as in the current budget. Further demand for consumption will be spurred by increased social payments, which due to the current economic slowdown, will be too much to absorb in full - unleashing higher inflation.

The Disturbing Economic Slowdown

GDP slips

GDP growth: four-fold slowdown

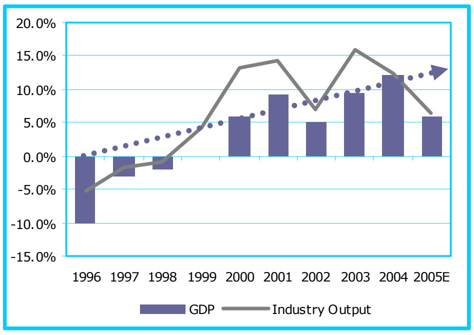
A sharp deceleration in Ukraine's economic growth observed in first quarter of 2005 continued during the April-June period. As a result for the first six months of this year GDP growth rates were more than three times less that of the same period in 2004 - 4.0% yoy vs. 12.7% yoy. The following reasons explain this years moderate growth:

- External factors played a negative role – a 30% drop in steel prices on world markets observed in April-June resulted in production decline for Ukraine's steel industry which represents ~1/3 of its total industrial output

- It is common knowledge that no economy can constantly accelerate its growth rates, in particular if we take into account what Ukraine's economy achieved during the previous two years: 9.4% in 2003 and 12.1% in 2004. The economy is starting to follow a cyclical pattern of development: two years of accelerated growth and one year of slowdown

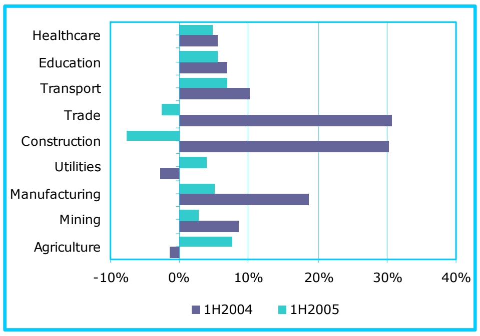
- Ukraine is currently in the process of large-scale political and economic transformation. Old rules and schemes are being throw out but new ones have not yet taken shape. The whole economy is adopting to the new conditions

GDP And Industry Output, % yoy



Source: *the State Statistic Committee*

GDP Dynamics By Sector, % yoy



Source: *the State Statistic Committee*

Industry slows…

Ukraine's economy which is driven by the industrial segment, was adversely affected by the sharp slowdown in industrial output this year. For the first six months of 2005 industrial output demonstrated moderate growth rates: 5.0% yoy vs. 15.9% for the same period in 2004.

Construction was also an important retractor, declining 7.7% compared to a remarkable 30.3% growth rate in 1H04. However large-scale Capex projects planned in the metallurgy (up to USD 9.0 bln for 2005-2010), utilities (~USD 200 mln for 2005-06) and transport sectors make us optimistic that growth levels in construction will bounce back.

The 1H05 decline of 2.5% (+30.7% in 1H04) in wholesale & retail trade was another negative factor. However it is important to note the drop in trade was caused by 7.3% fall in wholesale trade reflecting the general slowdown in industry. As a result of the remarkable increase in household incomes, retail trade flourished, posting a 19.8% yoy increase in 1H05. A.T. Kearney's 2005 global retail development index ranks Ukraine #3 among the top-30 emerging markets.

Industry: New Industries Drive Growth

Unprecedented growth rates were demonstrated by all industries last year and Ukrainian industry grew at median annual rates of 13.2% from 2000 throughout 2004. In the wake of this, 2005 figures look worse than just moderate - 1H05 marked a sharp reduction in industrial output to +5.0% (15.9% in 1H04), with a slow down observed in all industries.

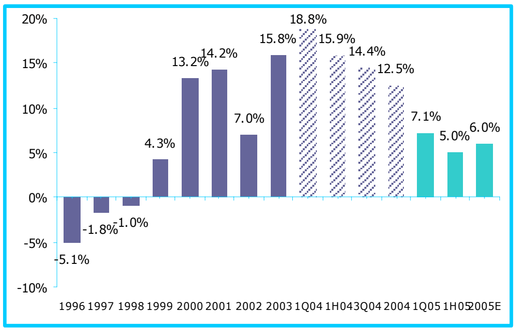
Drop in metallurgy, the main reason for the slump

The fall in metallurgy had a large impact on total industry growth as 1H05 output in the sector dropped -1.8% yoy (17.5% yoy in 1H04). The resulting contribution (see the chart below) to total industry growth in 1H05 was negative at -10.0% (30.2% in 1H04). Reasons:

1) Fewer export opportunities. During April-June world steel prices fell by ~30%. Given that exports account for around 75% of the total steel industry output, adverse price trends on world markets had huge negative effect on Ukraine's metallurgy sector
2) Lower domestic demand due to stagnation in construction (-6.7% yoy in 1H05)
3) Political uncertainty – some metallurgical companies are targets for re-privatization, which pressed owners to harbor funds in affiliated structures.

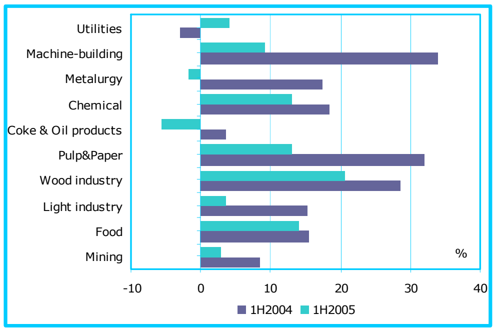
The sag in metallurgy negatively affected Ukraine's coke industry. For first half of the year coke output fell by 5.6% yoy, As a result the sector's contribution to total industry growth in 1H05 was also negative (-6.0%).

Industrial Output, cumulative chg. %



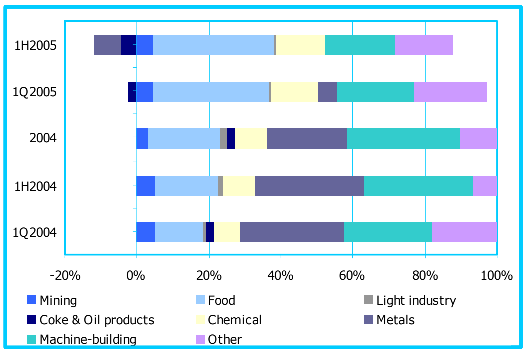
Source: the State Statistic Committee

Industrial Output Dynamics By Industry, %



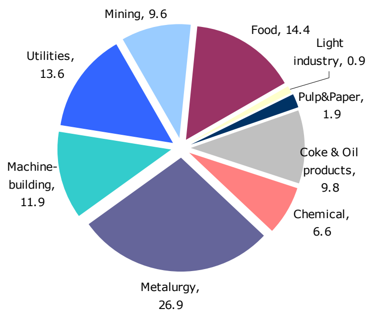
Source: the State Statistic Committee

Contribution To Industry Growth By Sector



Source: the State Statistic Committee, Concorde

Industry Output By Sector, 1H2005



Source: the State Statistic Committee

New sectors drive industry growth

Chemicals, food and machine-building were the major contributors to industrial output growth during 1H05. More than 80% of total industry growth is due to the positive dynamics in these three industries. Strong external demand supported a 13% yoy growth in chemicals (18.4% in 1H05) and accounted for 18.0% of total industry growth in 1H05 (6.9% in 1H04). Encouraged by the robust growth of household incomes (real household incomes grew by 26.8% yoy) food output advanced by 14% yoy over the period. In 1H05 this sector was a major contributor to total industry growth outpacing last year's leaders: metallurgy and machine-building. Food output increased its contribution from 17.6% in 1H05 to 44.0%.

The industry structure remains unchanged

The industrial output structure of different sectors remained the same in 1H05. Four sectors continued to dominate Ukraine's industry: metallurgy (~27% of total industry output), food (14.4%), utilities (13.6%) and machine-building (11.9%).

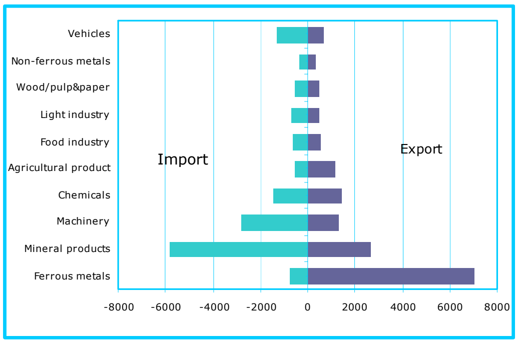
Ukraine's industry remains focused on raw material production. Thus for the first five months of the year the share of raw material products in total output was 70%, while investment products accounted for just 12%. Consumer goods accounted for 16.8% and durable goods a mere 1.2%.

Foreign Trade: Export / Import Interchange

Export slower, import faster…

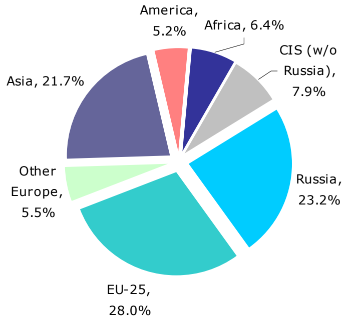
In 1H05 exports of goods increased 9.2% yoy to USD 16.9 bln, a five-fold drop in growth rates compared to 2004's remarkable 50.8% yoy. Meanwhile import dynamics have been steadily accelerating in first half of 2005 (26.0% yoy versus 33.0% yoy in 1H04). Imports amounted to USD 16.5 bln after the first six months. Such dynamics resulted in 1H05's merchandise balance diminishing to just USD 0.38 bln in comparison with 1H04's remarkable USD 2.4 bln. Due to the export surplus in services (USD 1.56 bln) the 1H05 total foreign trade balance amounted to USD 1.94 bln, that accounted for 5.8% of GDP during the period. We estimate total imports will keep outpacing exports for the rest of the year: with 22% and 8% annual rates respectively, due to the appreciation of national currency, simplified custom procedures and growing internal demand. This will result in the trade balance diminishing from 10% of GDP in 2004 (one of the largest in Europe) to ~7% in 2005.

Foreign Trade Composition, 1H05



Source: the State Statistic Committee

Export By Region, 1H05

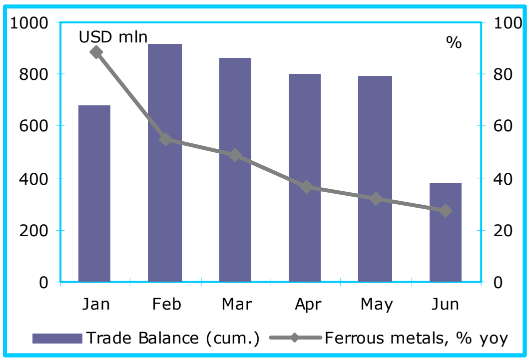


Source: the State Statistic Committee

Export potential shocked by external forces

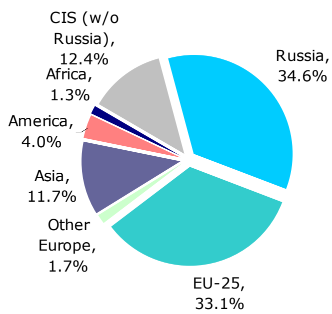
The adverse steel price trend on world markets (a ~30% fall was observed during April-June) seriously undermined the export potential of Ukraine's metallurgy. The growth rates of ferrous metal exports for 1H05 were sliced in half from 51.2% yoy in 1H04 to 27.2% in 1H05. Given that ferrous metals are a major component (40% of total exports) of Ukraine's exports, it was a big reason for the slowdown of total export growth in 1H05. However in July-August world steel prices started to bounce back (+5%) that may restore the growth of exports in the segment to around 35% yoy by the end of the year.

Trade Balance & Fe-Metals Export Growth



Source: the State Statistic Committee

Import By Regions, 1H2005



Source: the State Statistic Committee

Foreign trade profile unchanged

The structure of Ukrainian foreign trade did not change: with metals and chemicals together accounting for more than 50% of total exports, Ukraine is maintaining its raw materials export profile. Import remained dominated by minerals (35%) and machinery (16.8%).

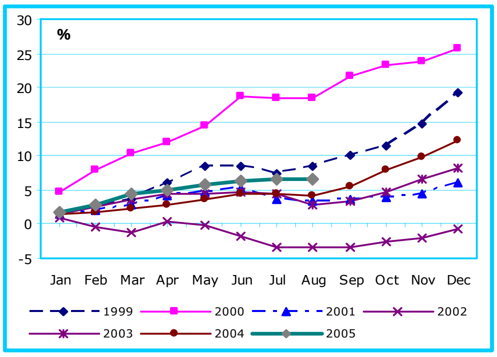
Ukraine has well balanced trade with the EU and the CIS (excluding Russia). It a is net exporter to Asia, and remains heavily dependant on importing energy from Russia. Worth noting: in 2004 Ukraine achieved the highest Current Account/GDP level (11%) in the CIS, which is twice the average figure for net energy importing countries from the CIS. According to IMF estimates, this tendency will persist in 2005: 7.2% for Ukraine vs. 3.1% for CIS net energy importers.

Inflation: A Persistent Headache

We expect CPI of 13% in 2005

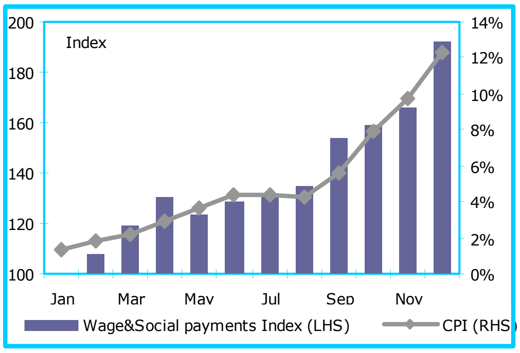
Consumer inflation was noticeably higher in 1H05 than during the same period in 2004. The cumulative CPI growth rate during the first six months of 2005 was 6.4% (4.4% in 1H04). A slowdown in the quarterly CPI rate from 4.4% in 1Q05 to 1.9% during 2Q05 leaves room for hope that the government will manage to contain inflation at relatively reasonable limit. However, we consider the government's 9.8% forecast for annual inflation to be too optimistic. Our expectation for annual CPI is 13%.

Cumulative Inflation, %



Source: the State Statistic Committee

Social Payments And CPI In 2004

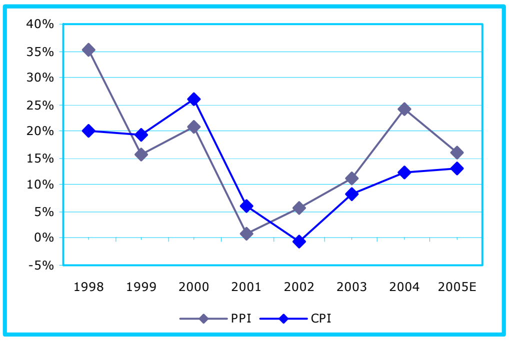


Source: the State Statistic Committee

Soaring consumer demand is pushing CPI up

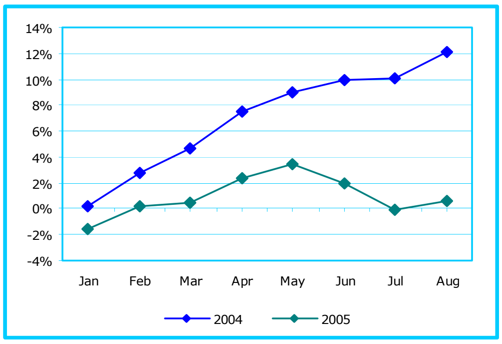
The new government inherited accelerating inflation of 12.3%, half of which accumulated in 4Q05 (6.3%) spurred by a populist increase in social payments on the eve of the presidential elections. So consumer demand that was "warmed-up" in the end of 2005, made its effect on the growth of consumer prices in 1Q05. In April 2005, a new social program that cost an additional 33% over what was spent in 2004 to USD 6.3 bln was launched by the new government. The increase in social payments benefited the low-income section of the population, which in turn directed additional funds towards consumption pushing the CPI rate higher. On the supply side the surge in gasoline prices (+35% in 1H05) was another important CPI growth factor.

CPI & PPI Dynamics, % yoy



Source: the State Statistic Committee

CPI/PPI Differential, %



Source: the State Statistic Committee
** calculated: PPI-CPI (cumulative rates)*

PPI eases pressure on CPI

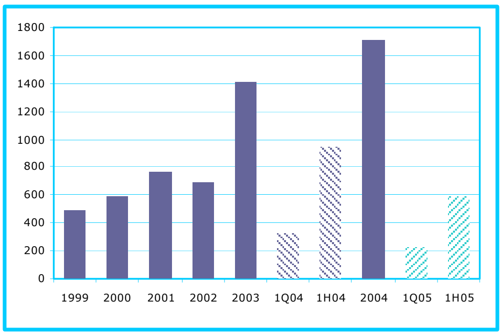
The gap between PPI and CPI rates reduced sharply in 1H05 (2% vs. 10% in 1H04), thus easing the pressure on consumer prices from the producers' side. The reason for lower the PPI/CPI differential was moderate growth in producer prices: 8.3% in 1H05 vs. 14.4% during the same period in 2004. The fall in world steel prices as well as lower internal demand caused a slowdown in price growth in metallurgy (from 22.1% in 1H04 to 9.0% in 1H05) and the coke industry (from 53.5% to a mere 2.3%).

Investment Pause

Foreign investments leaves much to be desired

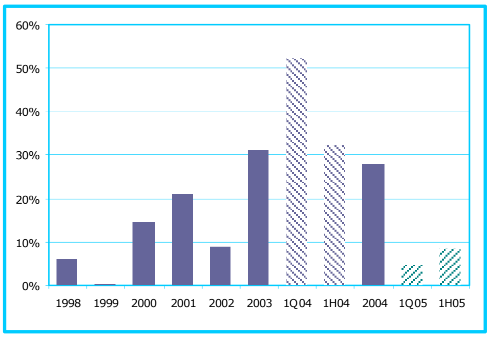
Foreign investments have not been pouring into Ukraine so far, in 1H05 FDI inflow to Ukraine dropped to USD 586 mln from USD 940 mln in 1H04. It seems that the image of a young democratic country is not sufficient to attract large-scale investments. The uncertainty as to the immediate future (prolonged re-privatization), the lack of a clear-cut government investment strategy (nothing except general proclamations), the slower than expected pace reforms, all harmed investor perceptions and made them take a wait-and-see position as to Ukraine. A drastic change in sentiment is unlikely to happen by the end of the year. Therefore, FDI in 2H05 will likely keep growing at the same pace and total ~USD 9.6 bln cumulative since 1991.

Net FDI Inflow, USD mln



Source: National Bank

Fixed Capital Investments, % yoy



Source: the State Statistic Committee

Capital investments slow drastically

A more disturbing tendency observed this year was a sharp fall in the growth rates of capital investments: 8.5% yoy in 1H05 vs. 32.2% yoy in 1H04. In recent years, internal funds from enterprises accounted for 61%-62% of national capital investments. When amending the 2005 budget, the government increased the share of payments to the budget from state-run companies: from 15% to 30% for joint stock companies (where the state has at least 50%+1 share stake) and 50% for other state companies. This limited the companies' ability to invest and undermined, to some extent the main source of capital investments, while the state's share in total capital investment remains insignificant. Two state monopolies alone, Ukrtelecom and Ukrnafta, paid together USD 406 mln in dividends during 1H05, with a payout ratio of 100% and 83% respectively.

The uncertainty as to long-run perspectives caused by the threat of re-privatization made many companies postpone their investment projects. A substantial slowdown in capital investments was seen in industry (~40% of total capital investments) and in particular, in metallurgy and mining. Many companies in these sectors are the primary targets for re-privatization. Therefore, the owners of these companies preferred to direct company profits towards dividend payments rather than investment. Thus Kryvorizhstal (#1 target for re-privatization) paid USD 139 mln in dividends (payout ratio of 35%), Severniy GOK paid USD 97 mln (95%), Centralniy GOK paid USD 38 mln (60%).

	Real GDP, % chg		Real Investment, % chg		Investment/GDP %
	2000-04	2004	2000-04	2004	2004
Ukraine	**8.4**	**12.1**	**36.1**	**26.5**	**17**
Czech Rep	2.9	3.1	5.8	7.7	28
Hungary	3.8	3.8	6.6	11	26
Slovak Rep	4.1	4.9	1.7	6.3	26
Poland	3.2	5.8	-1.6	5.5	18
Croatia	4.1	3.7	7.8	7	29
Bulgaria	4.8	5.5	13.8	15	23
Roamnia	5	7.2	8.9	12	25
Russia	6.7	6.5	10.9	10	24
Turkey	5.1	12	15.6	53.7	28

Source: Standard & Poor's, National Bank

Economic Indicators: International Comparison

Country	Ratings S&P	Real GDP, % yoy			CPI, %			Current Account Balance, % to GDP		
		2004	2005E	2006E	2004	2005E	2006E	2004	2005E	2006E
CIS countries										
Ukraine	**BB-**	**12.1**	**5.5**	**5.4**	**9**	**14.2**	**12.1**	**11.0**	**5**	**0.2**
Russia	BBB-	7.2	5.5	5.3	10.9	12.8	10.7	10.2	13.2	13
Kazakhstan	BBB-	9.4	8.8	7.7	6.9	7.4	7.1	2.3	3.9	2.8
Belarus	-	11	7.1	4	18.1	12.1	12.5	-3	-3.7	-3.4
Armenia	-	10.1	8	6	7	2.2	3.9	-5.8	-5.1	-5.4
Georgia	-	8.5	7.5	4.5	5.7	9	7	-7.5	-11.8	-7.2
Kyrgyz Republic	-	6	4	5.5	4.1	5	4	-2.8	-4.9	-4.8
Moldova	-	7	6	5	12.3	13.3	11.9	-4.4	-4.6	-3.2
Tajikistan	-	10.6	8	7	7.1	7.2	5	-4	-4.9	-4.3
Uzbekistan	-	7.1	3.5	2.5	8.8	14.1	13	0.8	4.5	3.9
Central Europe										
Czech Republic	A-	4.4	4.1	3.9	2.8	2	2.5	-5.2	-3.5	-3.2
Hungry	A-	4.2	3.4	3.6	6.8	4	3.6	-8.8	-8.5	-8
Poland	BBB-	5.4	3	4	3.5	2.2	2.5	-1.5	-1	-2.5
Slovak Republic	A-	5.5	5	5.4	7.5	2.7	2.7	-3.5	-6.3	-6.4
Slovenia	AA-	4.6	3.9	4	3.6	2.6	2.5	-0.9	-1.6	-0.8
South and south-eastern Europe										
Bulgaria	BBB-	5.6	5.5	5.5	6.1	4.4	3.5	-7.5	-9	-8.5
Cyprus	A	3.7	3.8	4	2.3	2.5	2.5	-5.8	-4	-3.2
Malta	A	1	1.5	1.8	2.7	2.4	1.9	-10.4	-10.5	-8.6
Romania	BB+	8.3	5	5	11.9	8.8	6.9	-7.5	-7.9	-7.8
Newly industrilized Asian economies										
Korea	A-	4.6	3.8	5.0	3.6	2.8	2.9	3.9	2	1.5
Taiwan	AA-	5.7	3.4	4.3	1.6	2	1.8	6.2	4.3	4.6
Hong Kong	A+	8.1	6.3	4.5	-0.4	1	1.3	9.6	10.3	10.2
Singapore	AAA	8.4	3.9	4.5	1.7	0.7	1.7	26.1	25.7	22.7

Source: International Monetary Fund

Ukrainian Macro Indicators

Real Indicators	2000	2001	2002	2003	2004	1H2005	2005E
GDP real growth, %	5.9	9.2	5.2	9.4	12.1	4.0	5.0
Nominal GDP, USD mln	31262	38009	42393	49537	65039	33426	86078
Industrial output growth	12.4	14.2	7.0	15.7	12.5	5.0	6.0
Capital Investments Growth	14.4%	20.8%	8.9%	31.3%	28.0%	8.5%	10.0%
CPI (eop), %	25.8	6.1	-0.6	8.2	12.3	6.4	13
PPI (eop), %	20.8	0.9	5.7	11.1	24.1	9.2	16
Foreign economic activity							
FDI annual, USD mln	593	680	917	1323	1560	586	1077
FDI (Cumulative since 1991), USD mln	3875	4555	5472	6794	8570	9061	9647
Current Account Balance, % GDP	4.6	3.7	7.5	5.9	10.5	6.8	5
Total Exports, USD mln	19248	19809	22012	27328	37980	19695	41000
Export Growth, %	17.9%	2.9%	11.1%	24.2%	39.0%	10.5%	8.0%
Total Imports, USD mln	18166	16924	18164	24409	31004	17752	37800
Import Growth, %	19.2%	-6.8%	7.3%	34.4%	27.0%	28.5%	22.0%
Trade Balance, USD mln	1082	2885	3848	2919	6976	1943	3200
Debt							
Total Public Debt, USD mln	14173	14085	14202	14543	16096	15733	16055
Total Public Debt, %GDP	45.3	37.1	33.5	29.4	24.7	--	18.8
NBU Reserves, USD mln	1475	3089	4417	6940	9525	13072	14000
Social indicators							
Population, mln	48.9	48.5	48.0	47.6	47.4	47.2	47.1
Unemployment (ILO)	11.7	11.1	10.1	9.1	8.5	8.5	8.2
Monetary indicators							
Monetary Base (M0), USD mln	2353	3623	4963	6211	7681	10159	10188
Broad Money (M2), USD mln	5798	8411	12075	17714	23494	30911	32000
Money Supply (M3), USD mln	5928	8517	12179	17823	23593	30123	30671
Money Supply Growth, %	11.0%	43.7%	43.0%	46.3%	32.1%	27.7%	30.0%
UAH/USD (eop)	5.435	5.299	5.332	5.332	5.31	5.05	5.00
UAH/USD (avg)	5.440	5.372	5.327	5.333	5.32	5.17	5.10
Budget, % GDP							
Revenues	28.9%	26.9%	27.4%	28.5%	26.0%	33.7%	24.2%
Expenses	28.3%	27.2%	26.7%	28.6%	28.9%	32.6%	26.0%
Budget Balance	-0.7%	-0.3%	0.7%	-0.2%	-3.0%	1.0%	-1.7%

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