CONCORDE CAPITAL

Ukraine / Macro

Food inflation

Sunny side: Agriculture

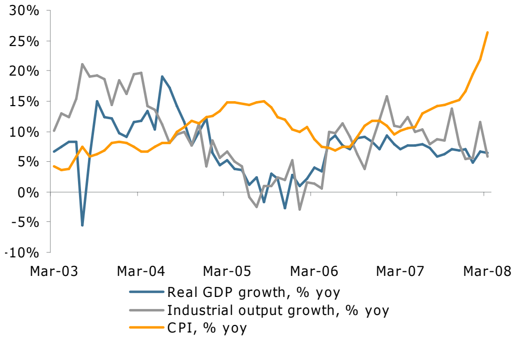
Polina Khomenko +380 44 391 5577
pk@concorde.com.ua

Andrii Parkhomenko
pav@concorde.com.ua

Konstantin Fisun, CFA +380 44 391 3150
kf@concorde.com.ua

April 18, 2008

Business cycle indicators



Source: State Statistics Committee

Key macroeconomic indicators

	2007	2008E	2009F
Real Economy			
GDP real growth, %	7.6	6.8	6.5
Nominal GDP, USD bln	141.2	193.7	239.3
Industrial output growth, %	10.2	8.7	7.5
CPI (eop), %	16.6	21.0	15.0
PPI (eop), %	23.2	25.0	18.0
Retail trade growth, %	28.8	25.5	25.0
Banking assets growth, %	76.0	50.0	46.0
Construction growth,%	15.8	20.0	25.0
External Sector			
Total Exports, USD bln	64.0	81.4	97.7
Total Imports, USD bln	71.9	92.7	113.1
FDI inflow, USD bln	9.2	9.6	13.5
Trade Balance, USD bln	-7.9	-11.3	-15.4
Current Account, % GDP	-4.2	-5.1	-6.0
NBU Reserves, USD bln	32.5	35.7	37.5
Monetary & Fiscal Policy			
Money Supply Growth, %	51.7	25.0	40.0
UAH/USD (eop)	5.05	4.95	4.90
Consolidated Budget, % GDP	-1.1	-1.0	-0.7

Source: State Statistics Committee, National Bank of Ukraine, Concorde Capital estimates

Prices for core commodities

	Current	Chg yoy
Gas imports, USD/tcm	179.5	38%
Crude oil (URALS), USD/bbl	108.8	75%
Winter wheat (Ukraine), USD/mt	272.0	64%
Steel slab, export, Black/Baltic Sea, USD/mt	795.0	50%

Source: Bloomberg

Ukraine's inflation is at an eight-year high: CPI hit 26.2% yoy in March, driven by soaring global food prices and rapid growth in Ukrainians' disposable income following hefty social payouts since January. Escalating commodity prices pushed PPI up 31.7% yoy in 3M08. Though we forecast inflation to level off in the second half of the year, we temper our 2008 forecasts: CPI to 21% and PPI to 25%.

Policymakers' have responded with a whole spectrum of anti-inflationary tools, particularly in regards to monetary policy, the government even resorted to administrative measures, but the effect so far has been subdued. Nevertheless, banks' resource base is dwindling, and we expect credit activity to slowdown starting 2Q08. Since late March, the NBU has let the interbank USD/UAH rate drop below the strong side of the band it had supported since 2005. Though counter-inflationary, this will aggravate deterioration in the C/A balance – we forecast a 5.1% deficit in 2008.

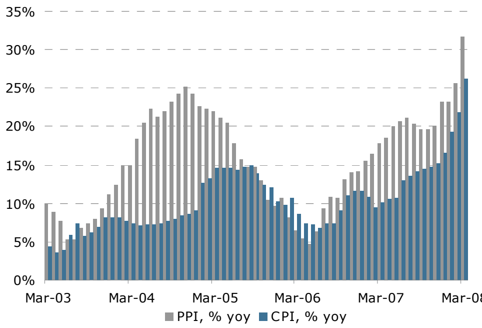
In the mid-term, we see the C/A deficit widening, but remaining covered by the financial account surplus: FDI inflows driven by activity related to cohosting the UEFA European Soccer Championship in 2012, major privatizations in 2008-2009 and continuing cross-border M&A activity. A new factor coming in the fold will be a WTO-induced boost in exports, primarily in agricultural commodities, supported by the global price rally. In 2008, we expect grain exports alone to contribute up to USD 2.5 bln over last year's result.

Agriculture is becoming a focal point in the national economy's transformation to a new level of long-run productive capacity. The abolishment of the moratorium on agricultural land sales, expected as early as 2008, will create a market for this resource and unleash investments into expanding and modernizing the sector. We forecast agricultural growth of at least 7% in coming years.

Contents

INFLATION CONCERNS

CPI & PPI growth, monthly % yoy

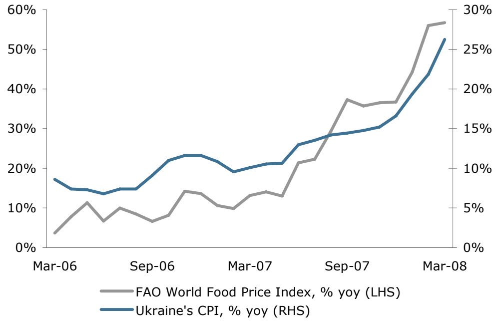


Source: State Statistics Committee

Ukraine slipped from 2007 into 2008 on an accelerating inflation that has now reached eight-year highs. This March, CPI surged 26.2% yoy vs. 16.6% yoy in 2007. Inflation has amounted to 9.7% YTD (vs. 1.3% last year).

The problem is not specific to Ukraine. Eurostat reported that 12-month inflation in the Eurozone jumped to 3.5% yoy in March, up from 3.3% yoy in February, and far above the ECB's 2% target. In the United States, inflation hit 4.0% yoy in the month of March.

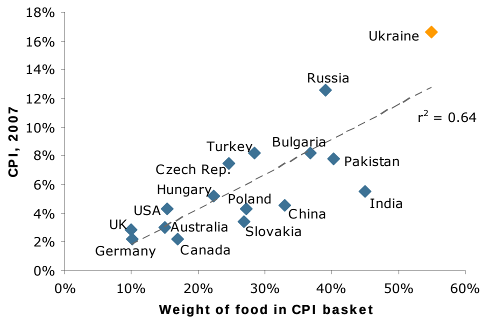
Ukraine's CPI rises along with FAO World Food Price Index



Source: State Statistics Committee, FAO

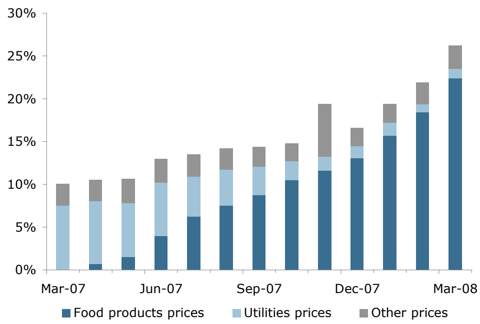
Ukraine, however, took a big hit. While oil, steel and other commodity prices beating historical maximums played a role, the major part of Ukraine's consumer inflation infiltrated into the national economy directly from a dramatic increase in global food prices, which has been on the uptrend since mid-2007. The FAO World Food Price Index made a scalding 36.7% yoy in 2007 (vs. annual average growth of 7.0% yoy over 2000-2006) and is still accelerating (12-month inflation as of March 2008 was 56.7%). Ukraine was more exposed than other countries, as food products account for a hefty 55% of the Ukrainian CPI basket, while the Ukrainian economy is among the most open in the world (the ratio of total external trade to GDP is 96% for Ukraine vs. the world average of 50.5%).

The higher weight food in the CPI basket, the higher inflation



Source: Bloomberg, State Statistics Committee, IMF, World Bank, National Statistics Committees, Concorde Capital estimates

CPI growth by components, % yoy

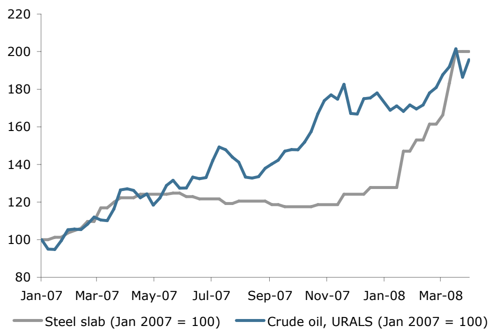


Source: State Statistics Committee, Concorde Capital estimates

So far, inflationary pressures have not spread beyond the food segment. We believe that non-food inflation will remain stable in 2008, and expect food prices to subside in the second half of the year. A plentiful harvest expected this year, close to eight-year high, should lend support. Nevertheless, we review our 2008 **CPI forecast** from 15.0% to 21.0%, as the factors sending food prices upward are not likely to abate in the short-term.

We also revise our 2008 **PPI forecast** from 19.5% yoy to 25.0% yoy.

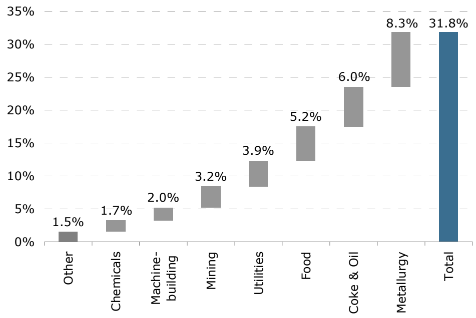
Prices for steel and crude oil jumped twofold since January 2007



Source: Bloomberg

Until October 2007, the situation resembled 2004-2005 when consumer inflation was on the rise while producer prices were declining. This time however, soaring prices for commodities led to accelerated cost pressure on the economy, particularly since the beginning of 2008, with a 38% hike in the imported gas price and the rally in steel prices.

PPI growth contribution by sector, March 2008



Source: State Statistics Committee

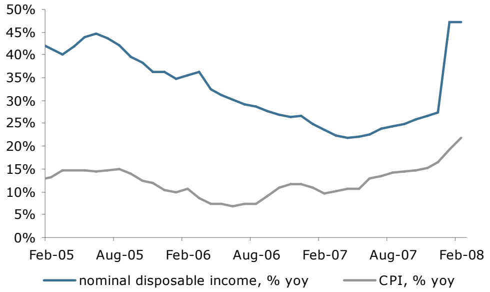
Of the 31.8% yoy producer inflation in 3M08, almost half was generated by metallurgy, coke and oil producers. However, we see already that a significant part of the PPI increase potential has been realized: annual prices for inputs in steel production have been contracted. Gas prices must remain stable for the rest of the year.

Moreover, Ukrainian producers will be able to pass through a significant portion of the elevated costs to overseas consumers: steel smelters export 70-75% of their output, fertilizer manufacturers - more than 90%, and machine builders - half. Hence, corporate profitability will not be undermined dramatically.

We see further cost pressure on the economy being moderate through yearend, and consumer inflation mostly driven by the demand side.

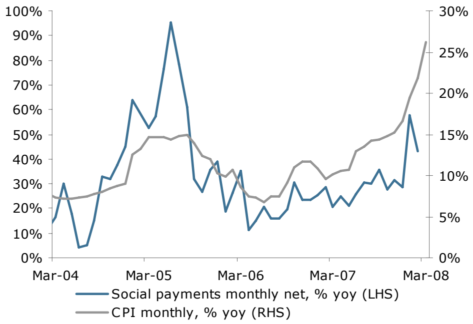
DEMAND-SIDE BACKGROUND

Growth rates: Disposable income vs. CPI



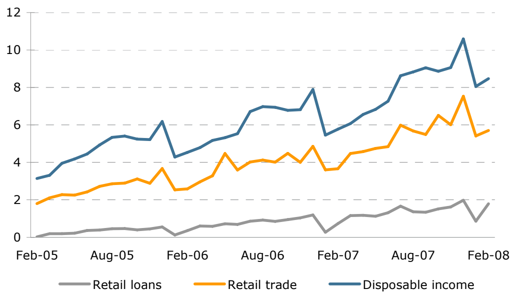
Source: State Statistics Committee

Social payments tend to prop up CPI growth



Source: State Statistics Committee

Retail trade vs disposable income, and loans to population, monthly, USD bln



Source: State Statistics Committee, National Bank of Ukraine

In the last few years, the government has pursued a policy to encourage consumption. We argue that up until recently, expansionary policy has played out well. Strong personal income growth (16.3% CAGR in real terms over 2004-2007), generous social payments (+33.4% CAGR over 2004-2007), and the NBU green-lighted consumer lending boom (115% CAGR over 2005-2007), combined to create a strong backdrop – increasing demand helped the national economy develop steadily: both real GDP and industrial output grew at 7.8% CAGR over the last five years, CPI remained under 12%.

Notably, the rate of growth in disposable income steadily diminished over three years, before changing direction in 2H07. The natural question is whether the dramatic trend-breaking jump back to 47% yoy growth in the beginning of 2008 will be digested by the national economy, given escalating inflation globally.

Boosted social payouts have lifted disposable income since January of this year. Historically, we see that accelerating social payments have tended to propel CPI growth. Over January-February, social payments amounted to USD 9.3 bln, 50% more than in 2M07.

This year's social payments also include the Tymoshenko government's initiative to start compensating the population for USSR Savings Bank (Sberbank) deposits devalued due to hyperinflation of 11,449% yoy in 1992. First of all, Tymoshenko's government raised the amount to be compensated more than four times from the previously acknowledged UAH 28.55 bln (USD 6.6bln) to UAH 126 bln (USD 25 bln). This would make Ukraine the most generous ex-USSR republic, though we do not believe that the full amount will be paid out in cash. At any rate, an initial USD 1.3 bln in compensation was included in the 2008 state budget, 66.2% of which had been paid out as of April 14.

Other social spending scheduled in the 2008 state budget:

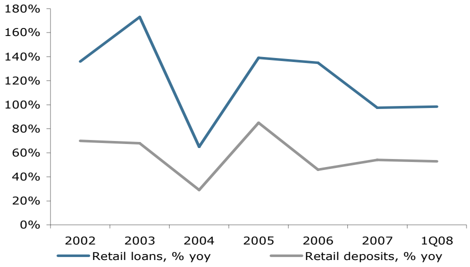
	01.01.2008	01.04.2008	01.09.2008	01.10.2008
Minimal pension	19.0%	2.3%		3.3%
Scholarship	93.5%		76.7%	
Birth payment	44.0%			

Source: 2008 State budget

Though increases in scholarships look impressive, their impact on monetary aggregates will be minor in absolute terms, the same with birth payments (total scholarship payouts will amount to a monthly average of USD 40 mln over 2008, while the monetary base was USD 24.8 bln as of March 2008).

The schedule is front-loaded with the major burden slated for the first month of the year. The government also used to talk about directing all excess proceeds from this year's privatizations to pay out more in compensation for depreciated savings in the Sberbank. This issue is politically charged, as Yulia Tymoshenko is striving to deliver on her parliamentary election promises from last autumn, and keep up momentum as the 2009 presidential elections approach. We doubt, however, that the government will make this aggressive push in the current inflationary environment. Moreover, recently we have heard government talk of accumulating any excess from privatizations on a treasury account for investment projects.

Growth in retail loans and retail deposits



Source: National Bank of Ukraine

Until late this year, we do not see any further accelerators for disposable income. Average salaries, according to our expectations, will continue growing at an annual rate of 25% during the year. So far, consumer lending has maintained unabashed growth (99% yoy during 3M08 v. 97% in 2007 FY). However, the results of the NBU's tightening policy since October must become more visible. In addition, the NBU is set to impose added reserve requirements to back consumer loans in order to put tougher brakes on consumer lending.

POLICYMAKERS' ACTION

The National Bank of Ukraine embarked on a policy of tightening money supplies in October 2007, three months after abnormal acceleration in inflation was obvious.

- *In October, the National Bank capped interest rates on foreign borrowings at the weighted average rate on Ukrainian sovereign Eurobonds +2%, which in practice would have stopped foreign borrowing for most local banks and thus restrained consumer crediting. A month later, this harsh measure was rescinded and replaced with the less strict introduction of a 4% reserve on foreign borrowing.*
- *On January 1, 2008, the NBU raised the rate by another 2 pp to 10% – the highest since 2004; though this rate in Ukraine is rather indicative of the general change in NBU policy.*
- *Since February 14, 2008, new components to CAR calculation were introduced. Open FX positions and long-term positive asset-liability maturity mismatches are now added to the calculation of risk weighted assets. This puts additional pressure on banks' capital adequacy. Given that two thirds of Ukrainian banks are stretched in their ability to inject fresh capital, this spells a contraction in lending expansion.*

The aforementioned measures led excessive liquidity enjoyed by Ukrainian banks to shrink in the last half year. In March 2008, the funds held by commercial banks on correspondent accounts with the NBU above the required level halved compared to the same period a year ago. The monetary base has fallen 3.9% YTD, versus 0.8% during the same period last year. The resource base of local banks is being exhausted, suggesting lenders must begin moderating expansion plans.

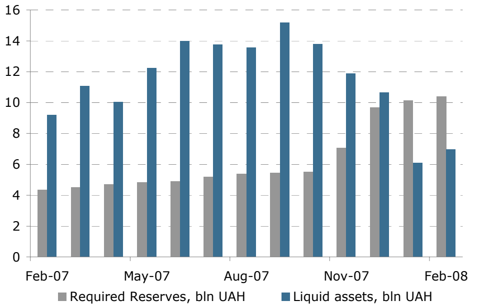
First quarter NBU statistics, however, do not show any sign of deceleration: loans to corporate clients increased 67% yoy vs. 65% yoy in 3M07, retail loans were up 99% yoy vs 97% yoy last year. Nevertheless, peaking interest rates reflect a narrowing availability of money. Large enterprises have already reported facing difficulties borrowing.

Overall it looks like monetary tools employed seem tuned to tackle more moderate inflation; the current exorbitant rates came as a surprise to both the NBU and government judging by their public statements swapping charges of responsibility for it.

It looks like the NBU decided that the timing is right to deploy another powerful monetary instrument capable of taming inflation – national currency appreciation against the US dollar. The NBU has not intervened to support the strong side of the band since late March. On April 16, USD/UAH rate was 2% below the bottom level the NBU de-facto tended since 2005. Assuming official NBU data that Ukraine's economy is 23% dollarized, the effect – if it is indeed the NBU's long-term policy - must be noticeable. Official NBU statistics does not account for dollars held by the population in cash, which is estimated at an additional 15% by the IMF. Related to this is an important element of the USSR savings compensation program: the bulk of payments to the population (83% or USD 0.8 bln) have been wisely made in US dollars.

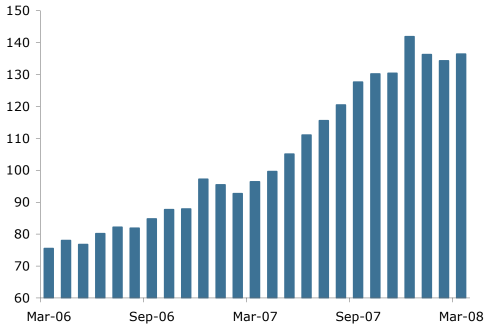
The side effect of a stronger Hryvnya could be a widening current account deficit, however we estimate that during 2008-2012 it will be successfully offset by capital inflows into the country (see the chapter "Current Account Deficit: Under Control" for more).

Bank's required reserves versus liquid assets



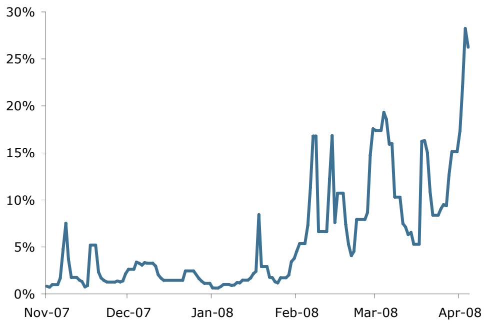
Source: National Bank of Ukraine

Monetary base, UAH bln



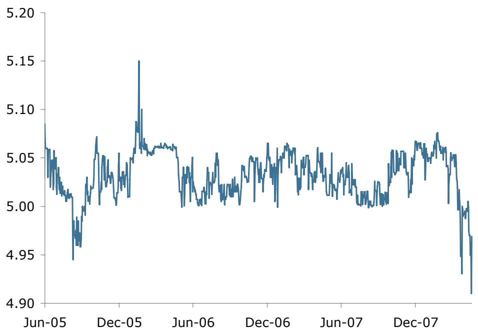
Source: National Bank of Ukraine

Kievprime overnight rate



Source: Bloomberg

USD/UAH interbank exchange rate



Source: Bloomberg

Treasury account changes, Jan-Apr

2003	36%
2004	36%
2005	19%
2006	-14%
2007	39%
2008	**93%**

Source: State Treasury

Our analysis of the state treasury account indicates that the government may also be utilizing this fiscal tool to counteract inflationary pressures in the short-term: The Ministry of Finance has certain leeway in releasing budget income for budget spending purposes. The average monthly amount of hryvnyas accumulated on the treasury account by mid-April 2008 had almost doubled since January 2008, while this growth did not exceed 39% yoy over the first quarters in any of the last five years. Just to give an idea of the scale – the UAH 6.7 bln (USD 1.3 bln) accumulated on the treasury account in the first three months of the year offset USSR savings bank payouts during the period (UAH 4.3 bln).

The Ministry of Economy has also employed administrative restrictions: since April 1, a 10% cap on the retailers' markup for the group of key food products came into effect – a result of government negotiations with retailers. The government also declared it will intervene in food commodities, by, for instance, importing cheap meat at a zero tariff. Again, the effect of administrative measures may only be short-lived.

Aggressive implementation of tightening monetary and administrative instruments alone, if prolonged, carry the risk of negatively affecting economic growth. In the following chapter, we state which fundamental forces are at play not only to prevent the economy from slowing down but to change its long-term productive capacity.

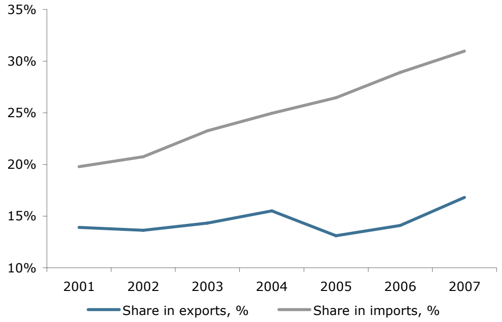
FUNDAMENTAL CHANGES ON THE WAY

Structure of GDP by expenditures

	2005	2006	2007	2008E
Gross investments	22%	24%	27%	28%
Private consumption	58%	60%	60%	62%
Government spending	19%	19%	19%	18%
Exports	54%	47%	45%	43%
Imports	-53%	-50%	-51%	-51%
GDP	**100%**	**100%**	**100%**	**100%**

Source: State Statistics Committee

Machinery gaining share in external trade



Source: State Statistics Committee

Over the last several years, the GDP structure has undergone encouraging changes. The dependence of GDP on external activity has been reducing: the share of imports was relatively stable at -53%...-50%, while exports' share shrank by 9 pp since 2005 and we expect a further decline in 2008. With government spending stable, the balance is captured by investment and private consumption, whose share has been rising.

While private **consumption** gained 2% in GDP since 2005, imports shed 2% - proving that expansionary policy has primarily benefited domestic production rather than imports. Even more telling is the **investment** component gaining more weight: since 2000, the share of capital investments in GDP increased from 19.7% to 26.9%.

Changes in the structure of **external trade** were also supportive: over last five years, machinery goods gained 3.2 pp to represent 16.8% in exports and 11.2 pp to 31.0% in imports. Although a significant portion of growing machinery imports is attributed to booming demand for cars, the majority of engineering imports have covered the investment needs of the economy.

We now see Ukraine in a position to take its national production capacity to a new level of long-run aggregate supply, with all relevant factors at play: level of technology, supply of resources, and institutional backing.

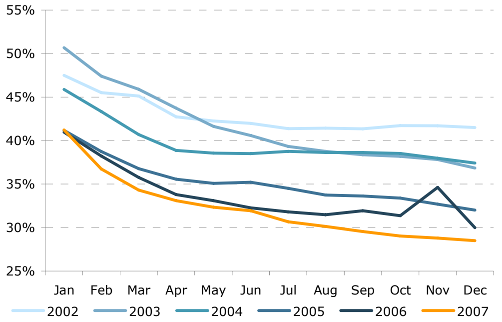
Powerful factors simultaneously at work a-la "carrot & stick" make the transformation, in our understanding, inevitable:

Stick #1. Price hikes on imported gas (24% in 2006, 37% in 2007 and 38% since January 2008) force the Ukrainian economy to adapt to higher natural gas prices which will converge to global market norms over the next one to three years. The cost of converting energy into GDP in Ukraine is one of the world's largest – almost twice the level of Russia and three times higher than in Germany, on a PPP basis. Natural gas represents 41% of the energy balance in Ukraine in fuel equivalent, according to the Ministry of Fuel and Energy. According to our estimations, with investments into transportation system upgrades, improving efficiencies by residential consumers and the implementation of more gas efficient industrial technologies, by 2015 an up to 15% reduction in gas consumption by the national economy is achievable.

Stick/carrot. WTO accession (ratified by parliament on April 10) will force investments into deep modernization and new technologies to protect and bolster the competitiveness of the national economy. Different sectors will be affected in different ways, but the consensus expert opinion is that in the long run, the aggregate effect of WTO membership for Ukraine will be 1 to 2 percent of the incremental GDP.

Carrot: Euro-2012 football championship co-hosted by Ukraine set the agenda for a large-scale transformation in the country's infrastructure. The National Program on preparing and conducting of Euro-2012 stipulates investments of USD 25 bln over 2008-2012 on infrastructure objects, which will make up around 2% of

Share of mineral products in goods imported shrinks

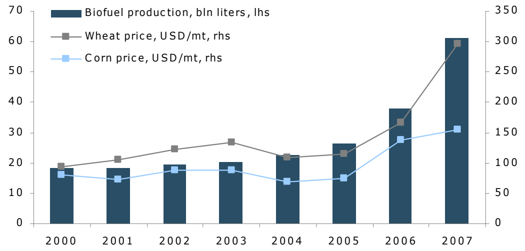


Note: Mineral products include crude oil, natural gas, coal
Source: State Statistics Committee

Agricultural & industrial output growth, yoy

Source: State Statistics Committee

Global biofuel production vs. crop prices



Source: Bloomberg, USDA

cumulative GDP over the next five years, according to our estimates.

In terms of **resources**, except for oil and gas, Ukraine is pretty much secure, including energy channels such as coal and uranium ore. We do not see any constraints in terms of physical supplies: Ukraine has long lived under market prices for oil; Ukraine is a transit territory from Gazprom's Siberian gas fields to end consumers in Western Europe, which under any scenario guarantees Ukraine gas supplies from traditional sources for at least the next five years.

Weak **institutional infrastructure** still remains one of the most sizable impediments on the way to long-term sustainable growth. According to the World Economic Forum's Global Competitiveness Report, in 2007 Ukraine ranked 115 out of 131 countries in terms of institutional development and 73rd by overall competitiveness. In Transparency International's 2007 Corruption Perceptions Index, Ukraine ranked 99th out of 163 countries in terms of corruption.

Though institutional reforms are not expected immediately, and will surely take years to be realized in full, we now see a focal point, with changes reasonably expected to get underway this year and shape more fully in 2009, pushing fast and radical changes – we mean *AGRICULTURE*.

The moratorium on agricultural land sales, which we expect to be abolished this year (2009 at the latest), is a seminal milestone. Our view is that agriculture can become a major driving force of economic growth in the mid-term. The sector has remained a trouble spot ever since Ukraine's independence in 1991. Extremely volatile, agricultural output has remained unpredictable, hinging on weather. The sector has remained fragmented, lacking long capital to finance investments into modern technologies, suffering from scarce working capital, etc....

With WTO accession and rampant global demand for agricultural commodities, we expect the agricultural sector can make up to a 1% contribution to Ukraine's GDP growth in 2008. The share of agriculture and food products was 12.7% in Ukraine's exports in 2007 and is likely to expand this year thanks to both high prices and a favorable harvest outlook. In the long run, this sector of the economy should become a stable and predictable component of growth.

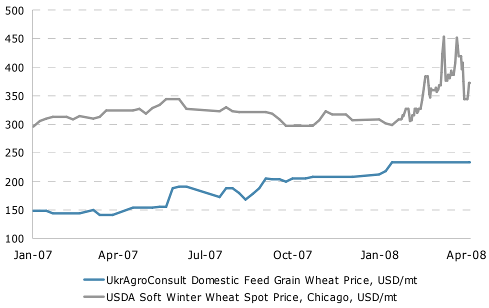
The global food market is undergoing long-term structural changes. As the era of cheap oil seems over, the economic feasibility of biofuel production is increasing. In 2007, 25% of the corn harvested in the US was processed into biofuel, which translated into 43% of the global corn literally being turned into fuel plants. The side effect is shrinking acreage planted by other cultures, including wheat. With the quick rise in global biofuel consumption over 2007, the supply of crops failed to keep pace with demand. The advancing wealth of emerging economies like China or India is putting additional pressure on world food production. An increasing number of developing economies are cutting exports of agricultural commodities to combat rising local prices.

Investment in agriculture, USD bln

2004	2005	2006	2007
0.66	0.98	1.42	1.88

Source: State Statistics Committee

Wheat prices Ukraine vs. global



Source: Bloomberg

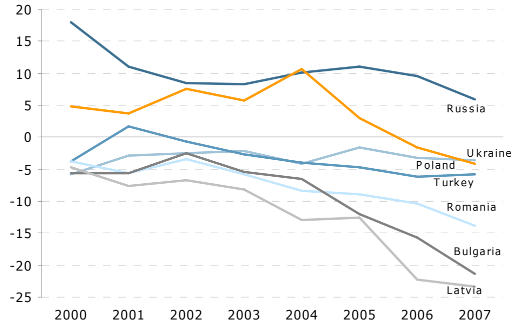
With this backdrop, Ukraine, where some 20% of arable land, among the world's most fertile, has been out of cultivation since the collapse of the USSR, is beginning to see mounting investments. With the inflow of capital, consolidation of farms into some of the world's largest agricultural enterprises, and investments into high-yielding technologies, within several years Ukraine has a real chance to restore its status as Europe’s breadbasket.

Private capital has started flowing into agriculture in recent years – mostly as investments into land consolidation. Not less than a dozen Ukrainian companies right now individually control agricultural lands of about 100 thousand ha or more. The Ukrainian agricultural sector began turning to public equity capital last year. Three pure agricultural producers have been listed since November 2007, and four other listed companies have exposure to this segment. Six of these alone (MCB Agricole, Land West, Landkom, Kernel, Dakor and Astarta) aggregately plan to invest nearly USD 380 mln in 2008 in expansion and modernization – a sizable 20% of annual investments in the whole sector last year.

WTO accession, with the resulting cancellation of export restrictions, syncs well with Ukrainian agricultural producers' investment agenda. We expect that grain exports could reach a robust USD 3.3 bln in 2008 (vs. USD 0.8 bln in 2007). The Ukraine Grain Association anticipates harvest in 2008 of 38-40 mln mt, up from 29 mln mt in 2007, whereas domestic demand is expected to be 25 mln mt. Agricultural producers have expanded planted areas by 15% yoy already in 2008 in an effort to better benefit from surging global prices. The cancellation of quotas (the current quota effective until April 30 limits exports to 1.2 mln mt) upon WTO accession will allow producers to export all surplus crops and sell them at international market prices, well above Ukraine's artificially depressed levels.

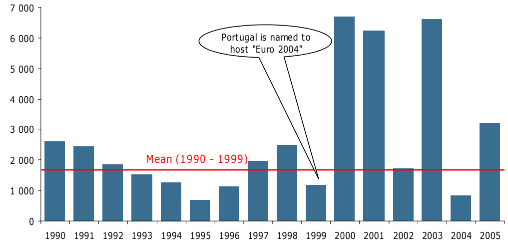
CURRENT ACCOUNT DEFICIT: UNDER CONTROL

Current Account deficit in CEE countries, % GDP



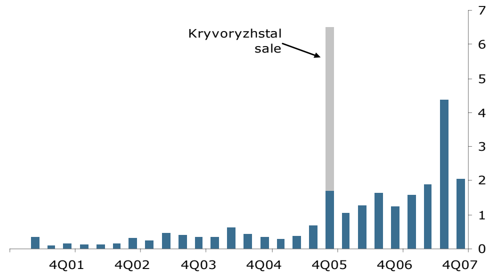
Source: International Monetary Fund

FDI in Portugal was on the rise during Euro-2004 preparation process, USD mln



Source: Bloomberg

Net FDI quarterly, USD bln



Source: National Bank of Ukraine

The uncaging of robust grain exports in 2008 is poised to counteract deterioration in the current account balance.

Ukraine's C/A has sharply slid into negative territory since 2005, and it looks like Ukraine will have to live with a negative balance in the years to come – nothing special: this situation is typical throughout CEE, except in oil-rich Russia.

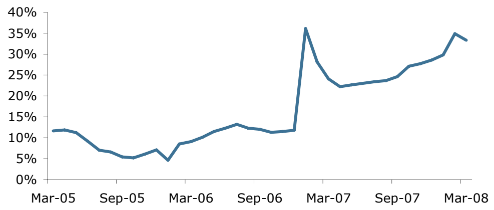
2007's current account shortfall of USD 5.9 bln could expand up to USD 10 bln in 2008, according to our estimates. While in 2007, the financial account surplus was USD 15.3 bln, in 2008 we forecast it at USD 14.2 bln; sufficient to continue covering the C/A deficit. As Euro-2012 and WTO accession must provide stimuli for strong FDI inflows, the current account imbalance is likely to remain capped by the financial account for at least the next four years. In 2008, we expect USD 2.5-3.0 bln in foreign direct investments in Euro-2012 related projects. See the case for Portugal, host of Euro-2004, on the left.

Our estimation of privatization receipts this year is USD 2.9 bln. We believe Ukrtelecom and six Oblenergos will be enough to cover this target... if not canceled as this year's other privatization candidates: the Odesa Portside Plant, Turboatom and four GenCos.

Cross-border mergers and acquisitions in different sectors of the economy could reach USD 5 bln, according to our estimations.

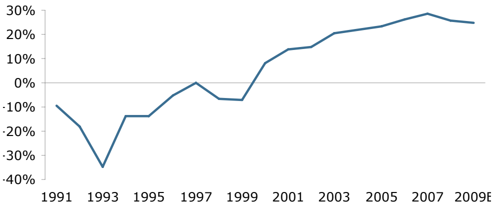
SECTORS IN THE SADDLE

Machine building output monthly, % yoy



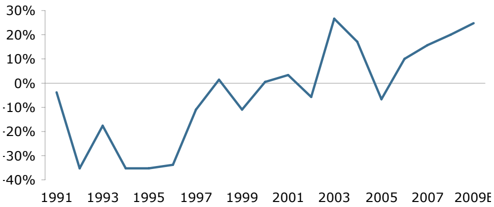
Source: State Statistics Committee

Retail trade growth yearly, % yoy



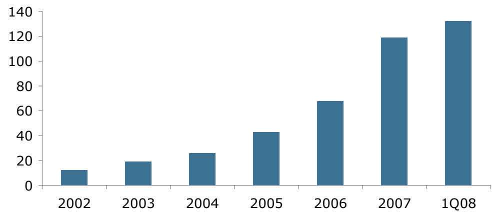
Source: State Statistics Committee

Construction growth yearly, % yoy



Source: State Statistics Committee

Banking assets, USD bln



Source: National Bank of Ukraine

The accelerating growth of investments into infrastructure and replacements in Ukraine and CIS countries is pushing up **machine building** output: 33.3% yoy in 1Q08 after 28.6% yoy growth in 2007. Given that expansion programs all over the CIS will continue, we expect the sector to be the main driving force of industrial output this year.

The CEE's fastest growing industry, **retail trade**, is riding the wave of soaring household spending. The sector surged 28.3% yoy in February, and continues to keep up the pace. The five largest retailers hold only 12% of the market, underscoring the potential for M&A activity involving big international players, such as French Auchan that entered the market last year.

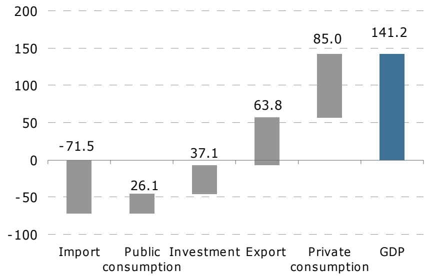
Construction grew 15.6% yoy in 2007, reflecting strong demand for both commercial and residential premises and benefiting from lofty prices for real estate. Although in 1Q08, the sector rose only 1.7% yoy, we expect it to pick up later this year, as Euro-2012 preparations along with the continuing need for real estate will generate firm demand for construction works, given that the National Program on preparing of Euro-2012 envisages investments of USD 25 bln over 2008-2012 for infrastructure objects.

Over last five years, the **banking** sector has grown at CAGR 58% yoy in terms of assets, continuing in 1Q08 at +70% yoy, however we expect the growth to taper off over the year due to tighter borrowing conditions caused by the global financial squeeze and stricter monetary policy by the NBU. Nevertheless, we forecast asset growth of 45-50% yoy in 2008. We expect that current market conditions will compel a mounting number of smaller banks to sell out, while foreign-owned will strengthen their positions.

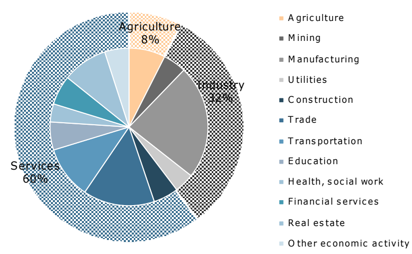
The **metallurgy** sector grew a mere 1.7% yoy in 1Q08, however we expect it to accelerate over the year due to the bullish outlook on steel prices and rising efficiency provided by modernization programs. Last year's consolidation (Evraz' takeover of Privat's iron ore assets and Metinvest's merger with Smart Group) provides the background for a decrease in costs and increase in the share of more value-added products.

MACRO MONITOR

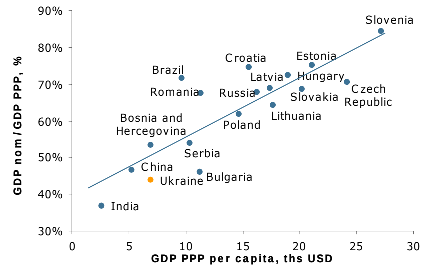
GDP by consumption in 2007, UAH bln



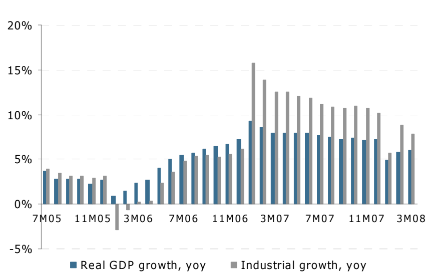
GDP by sector in 2007, USD bln



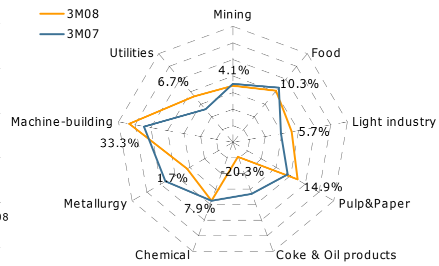
GDP PPP per capita in 2007



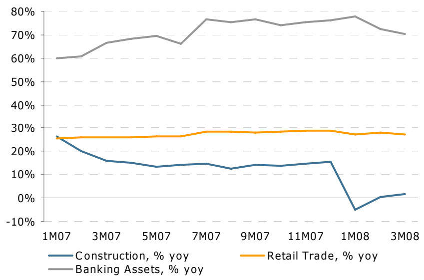
Real GDP & industrial output growth, % yoy



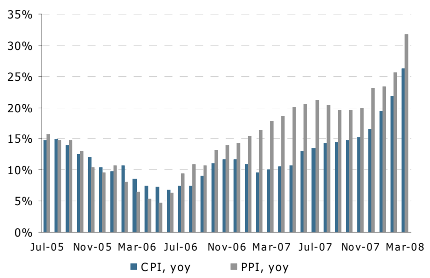
Industrial output growth by sector, % yoy



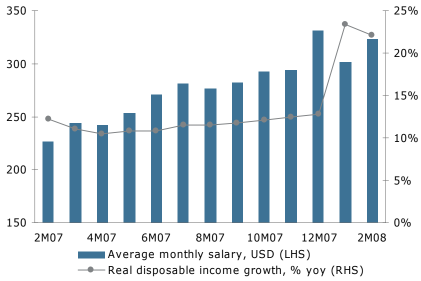
Banking assets, construction, retail, % yoy



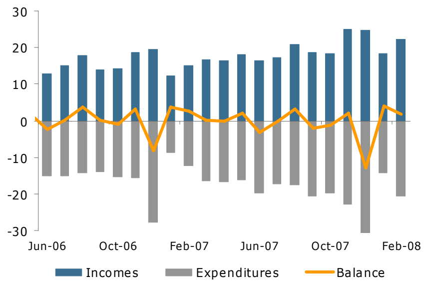
Inflation



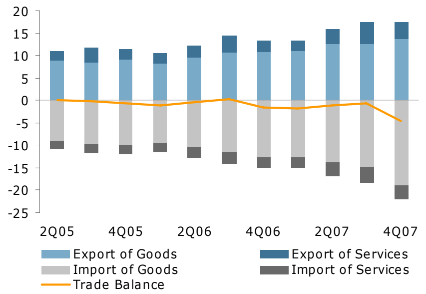
Real disposable income and average salary



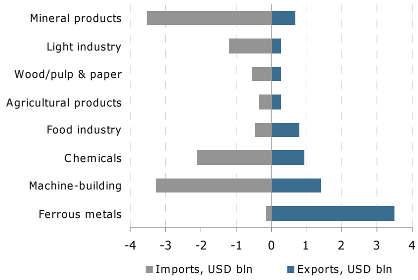
Consolidated Budget Execution, UAH bln



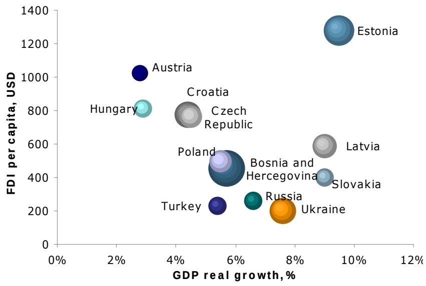
External Trade, USD bln



Merchandise External Trade in 2M08

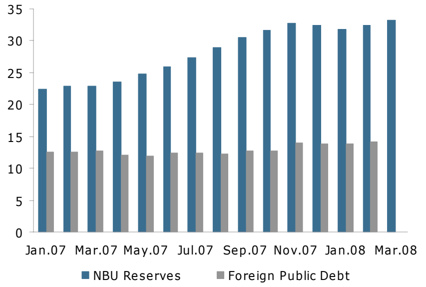


FDI per capita vs real GDP*, 2007E

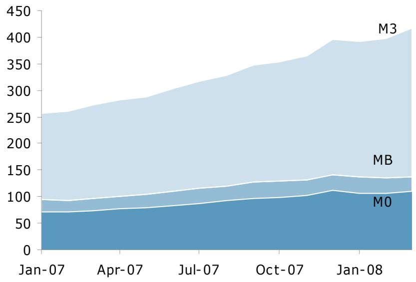


* Size of bubble indicates net FDI relative to GDP

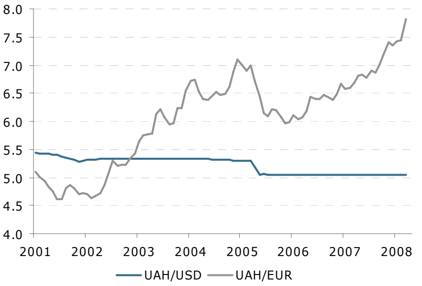
FX Reserves & Foreign Public Debt, USD bln



Money Supply Structure, UAH bln



Official exchange rate



Sources: National Bank of Ukraine, State Statistics Committee, IMF, Bank Austria Creditanstalt, Concorde Capital estimates

Ukrainian Macro Indicators Yearly

	2000	2001	2002	2003	2004	2005	2006	2007	2008E	2009F
Real Sector										
GDP real growth, %	5.9	9.2	5.2	9.6	12.1	2.7	7.3	7.6	6.8	6.5
Nominal GDP, USD bln	31.3	38.0	42.4	50.1	64.9	86.1	106.5	141.2	193.7	239.3
GDP per capita, USD	638	788	883	1,053	1,372	1,836	2,282	3,044	4,200	5,213
Consumption, % GDP*	75.3	76.6	75.4	75.4	71.2	76.5	78.6	78.6	77.7	77.4
Investment, % GDP	19.7	21.8	20.2	22.0	22.6	22.6	24.3	26.9	28.3	28.6
Industrial output growth, %	13.2	14.2	7.0	15.8	12.5	3.1	6.2	10.2	8.7	7.5
Agriculture growth, %	n/a	10.2	1.2	-11.0	19.9	-0.1	2.5	-5.6	7.0	7.0
CPI (eop), %	25.8	6.1	-0.6	8.2	12.3	10.3	11.6	16.6	21.0	15.0
PPI (eop), %	20.8	0.9	5.7	11.1	24.1	9.5	14.1	23.2	25.0	18.0
Retail trade growth, %	6.9	11.8	16.6	20.6	18.9	22.4	26.5	28.8	25.5	25.0
Banking assets growth, %	25.1	27.4	33.0	57.0	35.0	67.0	59.0	76.0	50.0	45.0
Construction growth,%	0.4	3.5	-5.8	26.5	17.2	-6.6	9.9	15.8	20.0	25.0
External Sector										
FDI net, USD bln	0.6	0.8	0.7	1.4	1.7	7.5	5.7	9.2	9.6	13.5
Current account balance, % GDP	3.5	3.3	7.5	5.8	10.6	2.9	-1.5	-4.2	-5.1	-6.0
Total exports, USD bln	23.4	21.1	23.4	29.0	41.3	44.4	50.2	64.0	81.4	97.7
Export growth, %	14.4	8.0	10.7	24.0	42.6	7.5	13.2	27.4	27.3	20.0
Total imports, USD bln	17.9	20.5	21.5	27.7	36.3	43.7	53.3	71.9	92.7	113.1
Import growth, %	17.8	14.1	5.0	28.7	31.3	20.4	22.0	34.8	29.0	22.0
Trade balance, USD bln	1.6	0.6	1.9	1.3	5.0	671.0	-3.1	-7.9	-11.3	-15.4
Debt Indicators										
Public debt, USD bln	14.4	12.5	13.8	14.5	16.0	15.5	15.9	17.6	19.5	21.5
Public debt, % of GDP	46.1	33.0	32.5	29.0	24.7	18.0	15.0	12.4	10.1	9.0
Gross external debt, USD bln	n/a	n/a	n/a	23.8	30.6	39.6	54.5	84.5	107.5	140.3
Gross external debt, % of GDP	n/a	n/a	n/a	47.5	47.2	46.0	51.2	59.9	55.5	58.7
NBU Reserves, USD bln	1.6	3.1	4.4	5.1	9.5	19.4	22.3	32.5	35.7	37.5
Social Indicators										
Population, mln	49.0	48.2	48.0	47.6	47.3	46.9	46.6	46.4	46.1	45.9
Unemployment (ILO), %	11.6	10.9	9.6	9.1	8.6	7.2	6.8	6.4	6.0	6.0
Avg Monthly Wages, USD	42.3	57.9	70.6	86.6	110.9	157.3	206.1	267.5	381.3	543.3
Real Disposable income, %	n/a	10.0	18.0	9.1	19.6	23.9	11.8	12.8	13.5	12.0
Monetary Indicators										
Monetary Base (MB), USD bln	3.1	4.3	5.8	7.5	10.1	16.4	19.3	28.1	34.4	46.9
Monetization (avg M3/GDP), %	15.7	19.2	24.9	30.3	32.0	36.7	42.3	46.4	46.1	50.2
Money Supply (M3), USD bln	5.9	8.6	12.2	17.8	23.7	38.4	51.7	78.4	100.0	141.5
Money Supply Growth, %	46.1	41.9	41.8	46.5	32.4	54.3	34.5	51.7	25.0	40.0
UAH/USD (eop)	5.44	5.29	5.33	5.33	5.31	5.05	5.05	5.05	4.95	4.90
UAH/USD (avg)	5.44	5.37	5.33	5.33	5.32	5.12	5.05	5.05	4.99	4.95
Consolidated Budget, % GDP										
Revenues	28.9	26.9	27.4	28.2	26.5	30.4	31.6	30.8	30.8	32.5
Expenses	28.3	27.2	26.7	28.4	29.7	32.2	32.3	31.9	31.8	33.0
Balance	0.6	-0.3	0.7	-0.2	-3.2	-1.8	-0.7	-1.1	-1.0	-0.5

** Includes private and government consumption*
Sources: State Statistics Committee, National Bank of Ukraine, Finance Ministry, Concorde Capital estimates

Ukrainian Macro Indicators Quarterly

	1Q06	2Q06	3Q06	4Q06	1Q07	2Q07	3Q07	4Q07	1Q08
Real Sector									
GDP real growth, % yoy	4.1	6.8	6.9	9.5	8	7.9	6.4	7.4	n/a
Nominal GDP, USD bln	20.9	24.6	29.8	31.2	26.4	32.0	40.1	43.7	37.6
GDP per Capita, USD	1,921	2,008	2,130	2,282	2,453	2,647	2,897	3,044	n/a
Industrial output growth, % yoy	0.2	3.6	5.5	6.2	12.5	11.8	10.7	10.2	7.8
Mining, % yoy	3.4	6.4	8.0	5.8	5.2	2.4	1.3	2.3	4.1
Manufacturing, % yoy	-0.8	7.1	9.0	6.3	14.8	12.6	10.0	10.2	8.3
Utilities, % yoy	7.4	3.3	12.2	6.7	-4.1	7.8	4.7	6.4	6.7
Agriculture growth,% yoy	4.0	2.8	-5.2	0.5	4.9	7.1	-9.4	-5.8	n/a
CPI, % yoy	8.6	6.8	9.1	11.6	10.1	13.0	14.4	16.6	26.2
PPI, % yoy	6.5	6.3	10.7	14.2	17.8	20.6	10.3	23.2	31.7
Retail trade growth, % yoy	26.2	25.5	24.4	26.5	25.8	26.4	28.2	28.8	27.2
Banking Assets growth, % yoy	50.5	54.4	56.5	59.1	66.4	72.9	76.9	76.2	70.7
Construction growth, % yoy	5.0	7.6	9.2	9.8	16.1	13.2	14.2	18.3	1.7
External Sector									
FDI net, USD bln	1.1	1.4	1.6	1.3	1.5	1.9	3.8	2.1	n/a
Current Account Balance, % GDP	-3.7	0.0	1.7	-4.3	-5.0	-2.0	-0.5	-6.6	n/a
Total Exports, USD bln	10.4	12.2	14.3	13.3	13.4	15.8	17.5	17.4	n/a
Export Growth, % yoy	-0.1	10.2	23.5	17.8	28.5	29.3	22.3	30.3	n/a
Total Imports, USD bln	11.5	12.6	14.2	15.0	15.1	16.8	18.2	21.9	n/a
Import Growth, % yoy	25.4	15.7	21.1	25.9	30.6	33.0	28.3	45.8	n/a
Trade Balance, USD bln	-1.1	-0.4	0.2	-1.7	-1.7	-1.0	-0.6	-4.5	n/a
Debt Indicators									
Total Public Debt, USD bln (eop)	14.9	14.6	14.5	15.9	16.0	15.5	16.3	17.6	n/a
Total Public Debt, % GDP	21.6	19.7	18.1	18.4	17.6	16.3	16.2	16.5	n/a
Foreign Public Debt, USD bln (eop)	11.2	11.1	11.0	12.7	12.7	12.4	12.7	13.8	n/a
Foreign Public Debt, % GDP	16.2	14.9	13.8	14.6	13.9	13.0	12.6	13.0	n/a
NBU Reserves, USD bln	17.3	17.6	19.1	22.3	23.0	25.9	30.6	32.5	33.2
Social indicators									
Population, mln (eop)	46.8	46.8	46.7	46.6	46.6	46.5	46.4	46.4	n/a
Unemployment (ILO), %	7.9	6.8	6.4	6.8	7.4	6.6	6.2	6.4	n/a
Avg Monthly Wages, USD	182	201	214	229	230	255	280	306	n/a
Real Disposable income, % (eop)	26.6	17.3	11.0	14.7	9.2	10.6	12.8	12.8	n/a
Monetary indicators									
Monetary Base (MB), USD mln	14.9	15.9	16.8	19.3	19.1	22.0	25.3	28.1	27.0
Monetization (avg M3/GDP), %	40.0	41.9	44.1	42.3	41.9	44.4	44.8	46.4	n/a
Money Supply (M3), USD mln	38.7	42.4	46.5	51.7	54.0	60.0	69.0	78.4	82.4
Money Supply Growth, % yoy	46.1	37.1	37.3	34.5	39.5	41.5	48.3	51.7	52.8
UAH/USD (eop)	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05
UAH/USD (avg)	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05
Consolidated Budget, % GDP (eop)									
Incomes	31.3	31.6	31.4	31.6	33.3	32.8	30.8	31.0	n/a
Expenditures	30.9	32.0	30.7	32.2	28.5	31.0	29.6	32.1	n/a
Balance	0.4	-0.4	0.7	-0.7	4.8	1.7	1.2	-1.1	n/a

Sources: State Statistics Committee, National Bank of Ukraine, Finance Ministry, Concorde Capital estimates

Ukrainian Macro Indicators Monthly

	2007									2008		
	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar
Real Sector												
GDP real growth, % yoy	7.9	7.9	7.9	7.7	7.5	7.3	7.3	7.2	7.3	4.9	5.8	6.0
Nominal GDP, USD bln, monthly	9.6	10.3	11.4	12.7	12.9	14.5	13.6	13.6	16.4	11.4	12.0	14.1
GDP per Capita, USD	2,509	2,570	2,647	2,719	2,798	2,897	2,978	3,050	3,044	3,105	n/a	n/a
Industrial output growth, % yoy cum.	12.5	12.1	11.8	11.2	10.9	10.7	11.0	10.7	10.2	5.7	8.8	7.8
Mining, % yoy cum.	5.2	4.4	3.8	2.8	2.7	2.9	2.9	2.8	2.7	3.8	4.7	4.1
Manufacturing, % yoy cum.	14.6	14.1	13.7	13.0	12.6	12.3	12.7	12.3	11.7	5.4	9.2	8.3
Utilities, % yoy cum.	-2.1	-0.6	0.5	1.1	1.4	1.7	2.4	2.9	3.2	11.3	9.4	6.7
Agriculture growth,% yoy cum.	3.4	2.4	6.3	5.5	-3.4	-5.1	-5.7	-5.7	-5.6	0.0	0.7	n/a
CPI (eop), % YTD	1.3	1.9	4.2	5.6	6.2	8.6	11.7	14.2	16.6	2.9	5.7	9.7
PPI (eop), % YTD	7.3	9.8	11.0	12.8	14.4	15.8	18.3	19.5	23.3	2.3	5.4	12.3
Retail trade growth, % yoy	25.9	26.4	26.4	28.4	28.4	28.2	28.5	28.9	28.8	27.1	28.3	27.2
Banking Assets growth, % yoy	68.3	69.4	66.2	76.5	75.3	76.9	74.3	75.4	76.1	78.0	72.3	70.6
Construction , real, % yoy cum.	13.1	11.5	11.8	11.9	10.2	11.6	11.0	11.3	15.6	-5.0	0.4	1.7
External Sector												
Merchandise Exports, USD mln cum.	14,794	18,877	23,112	27,371	31,539	35,653	39,999	44,449	49,246	3,657	8,349	n/a
Merchandise Export Growth, % yoy cum.	35.3	34.4	32.9	31.9	30.0	27.6	27.4	27.9	28.4	14.0	26.2	n/a
Merchandise Imports, USD mln cum.	17,772	22,624	27,306	32,621	37,494	42,346	48,219	54,041	60,670	3,763*	9,466*	n/a
Merchandise Import Growth, % yoy	35.9	35.0	33.8	35.0	33.8	31.5	32.9	34.9	34.7	1.5*	18.4*	n/a
Merchandise Trade Balance, USD mln cum.	-2,978	-3,747	-4,194	-5,250	-5,956	-6,693	-8,220	-9,592	-11,424	-107	-1,117	n/a
Debt Indicators												
Total Public Debt, USD mln	15,239	14,969	15,512	15,743	15,723	16,278	16,356	17,745	17,573	17,499	17,833	n/a
Total Public Debt, % of GDP	13.1	12.5	12.6	12.5	12.1	12.1	11.8	12.5	13.3	12.2	12.1	n/a
Foreign Public Debt, USD mln	12,035	11,935	12,368	12,343	12,305	12,734	12,697	13,931	13,849	13,850	14,173	n/a
Foreign Public Debt, % of GDP	10.3	10.0	10.0	9.8	9.5	9.5	9.2	9.8	10.5	9.6	9.6	n/a
NBU Reserves, USD mln	23,482	24,751	25,886	27,289	28,883	30,619	31,708	32,768	32,462	31,794	32,464	33,200
Social Indicators												
Population, mln	46.5	46.5	46.5	46.5	46.5	46.4	46.4	46.4	46.4	46.3	n/a	n/a
Avg Monthly Wages, USD	242.4	252.9	270.9	281.4	276.8	282.4	292.1	294.1	331.7	301.2	323.4	349.2
Real Disposable income, % mom	8.1	3.5	4.1	17.0	1.8	0.2	-4.9	0.2	0.1	-26.5	n/a	n/a
Monetary Indicators												
Monetary Base (MB), USD mln cum.	19,726	20,810	21,988	22,891	23,864	25,283	25,786	25,822	28,099	26,986	26,596	27,013
Monetization (avg M3/GDP), %	42.7	43.1	44.4	45.4	43.4	44.8	45.3	44.2	46.4	42.7	43.1	44.1
Money Supply (M3), USD mln cum.	55,913	57,066	60,003	62,766	65,142	68,956	70,134	72,394	78,447	77,491	78,854	82,423
Money Supply Growth, % mom	3.6	2.1	5.1	4.6	3.8	5.9	1.7	3.2	8.4	-1.2	1.8	4.5
UAH/USD (eop)	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05
Consolidated Budget, % GDP												
Revenues	33.5	33.8	32.8	31.7	31.7	30.8	30.3	31.0	31.0	31.7	34.3	n/a
Expenses	30.1	30.3	31.0	30.3	29.8	29.6	29.6	30.0	32.1	24.8	29.4	n/a
Balance	3.4	3.5	1.7	1.4	1.9	1.2	0.8	0.9	-1.1	6.9	4.9	n/a

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

International Comparison

	Real GDP, % yoy				Consumer Prices, % yoy				Current Account, % of GDP			
	2005	2006	2007	2008E	2005	2006	2007	2008E	2005	2006	2007	2008E
CIS countries												
Ukraine	**2.7**	**7.3**	**7.6**	**5.6**	**10.3**	**11.6**	**16.6**	**17.1**	**2.9**	**-1.5**	**-4.2**	**-7.6**
Armenia	14.0	13.3	13.8	10.0	-0.2	5.2	6.6	5.0	-3.9	-1.8	-6.5	-6.8
Azerbaijan	24.3	30.6	23.4	18.6	5.5	11.4	19.5	22.0	1.3	17.7	28.8	39.5
Belarus	9.3	10.0	8.2	7.1	7.9	6.6	12.1	10.2	1.6	-4.1	-6.6	-7.4
Georgia	9.6	9.4	12.4	9.0	6.2	8.8	11.0	8.0	-9.8	-15.9	-19.7	-16.6
Kazakhstan	9.7	10.7	8.5	5.0	7.5	8.4	18.8	10.0	-1.8	-2.2	-6.6	-1.7
Kyrgyz Republic	-0.2	3.1	8.2	7.0	4.9	5.1	20.1	15.0	3.2	-6.6	-6.5	-8.3
Moldova	7.5	4.0	5.0	7.0	10.1	14.1	13.4	9.0	-10.3	-12.0	-9.7	-10.3
Tajikistan	6.7	7.0	7.8	4.1	7.1	12.5	19.8	15.0	-2.5	-3.0	-9.5	-8.3
Turkmenistan	9.0	11.1	11.6	9.5	10.4	7.2	10.0	12.0	5.1	15.3	16.8	23.6
Uzbekistan	7.0	7.3	9.5	8.0	12.3	11.4	11.9	12.1	13.6	18.8	23.8	24.6
Baltics												
Estonia	10.2	11.2	7.1	3.0	3.6	5.1	9.6	7.1	-10.0	-15.5	-16.0	-11.2
Latvia	10.6	11.9	10.2	3.6	7.0	6.8	14.1	11.8	-12.6	-22.3	-23.3	-15.0
Lithuania	7.6	7.7	8.8	6.5	3.0	4.5	8.2	7.0	-7.1	-10.8	13.0	10.5
Central Europe												
Czech Republic	6.5	6.4	6.5	4.4	2.1	1.8	5.4	5.5	-1.6	-3.1	-2.5	-3.0
Hungary	4.2	3.9	1.3	1.8	3.3	6.5	7.4	4.7	-6.8	-6.5	-5.6	-5.5
Poland	3.6	6.2	6.5	4.9	0.7	1.4	4.0	3.9	-1.7	-3.2	-3.7	-5.0
Slovak Republic	6.0	8.5	10.4	6.6	3.7	4.2	3.4	3.3	-8.6	-7.1	-5.3	-5.0
Southern Europe												
Bulgaria	6.2	6.3	6.2	5.5	6.5	6.1	11.6	7.2	-12.0	-15.6	-21.4	-21.9
Croatia	4.3	4.8	5.8	4.3	3.6	2.0	5.8	3.8	-6.4	-7.9	-8.5	-9.0
Malta	3.3	3.4	3.8	2.2	3.4	0.8	3.1	3.4	-8.0	-6.7	-6.2	-6.1
Romania	4.1	7.9	6.0	5.4	8.6	4.9	6.6	6.3	-8.7	-10.4	-13.9	-14.5
Turkey	7.4	6.9	5.0	4.0	7.7	9.7	8.4	6.0	-6.2	-6.1	-5.7	-6.7
BRIC												
Brazil	2.9	3.7	5.4	4.8	5.7	3.1	4.5	4.5	1.6	1.3	0.3	-0.7
Russia	6.4	6.7	7.0	6.5	10.9	9.0	8.0	7.0	11.1	9.7	5.9	3.3
India	9.0	9.7	9.2	7.9	5.3	6.7	5.5	4.6	-1.0	-1.1	-1.8	-3.1
China	10.4	11.1	11.4	9.3	1.4	2.0	6.6	3.9	7.2	9.4	11.1	9.8

Source: IMF, April 2008

Concorde Capital
2 Mechnikova Street
21st Floor
Kyiv 01601, UKRAINE

Tel.: +380 44 391 5577
Fax: +380 44 391 5571
www.concorde.com.ua
office@concorde.com.ua

CEO
Igor Mazepa im@concorde.com.ua

Head of Equity Sales
Roman Nasirov rn@concorde.com.ua

Equity Sales
Anastasiya Nazarenko an@concorde.com.ua
Duff Kovacs, CFA dk@concorde.com.ua
Marina Martirosyan mm@concorde.com.ua
Andriy Supranonok sap@concorde.com.ua

Director of Research
Konstantin Fisun, CFA kf@concorde.com.ua

RESEARCH

Strategy
Konstantin Fisun kf@concorde.com.ua
Oleksandr Klymchuk ok@concorde.com.ua

Metals & Mining
Eugene Cherviachenko ec@concorde.com.ua
Andriy Gerus ga@concorde.com.ua

Utilities (Telecom, Energy)
Alexander Paraschiy ap@concorde.com.ua

Oil & Gas, Chemicals
Vladimir Nesterenko vn@concorde.com.ua

Consumer/Real Estate Group
Andriy Gostik, CFA ag@concorde.com.ua
Olha Pankiv op@concorde.com.ua
Alexander Romanov ar@concorde.com.ua
Anna Dudchenko ad@concorde.com.ua

Machinery
Eugene Cherviachenko ec@concorde.com.ua
Inna Perepelytsya pi@concorde.com.ua

Financial Services, Retail
Alexander Viktorov av@concorde.com.ua

Macroeconomics
Polina Khomenko pk@concorde.com.ua

Fixed Income
Oleksandr Klymchuk ok@concorde.com.ua

News/Production
Polina Khomenko pk@concorde.com.ua

Editor
Brad Wells bw@concorde.com.ua