



# STATUS COUNTRY REPORT UKRAINE: FINANCIAL TEST №45

June, 2014



## BY CREDO LINE INFORMATION & RATING AGENCY KIEV, UKRAINE

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## Main economic tendencies

Economic activity during June 2014 as in previous periods continued to be negatively affected by political unrest, especially in Eastern Ukraine and related uncertainties. Industrial production in Ukraine decreased the most noticeably. It was down by 5.0% yoy in June 2014, mainly as a result of 20.8% yoy drop in machine-building and a 21.7% yoy reduction in chemical industry, products of which had been exported to Russia. During January-June 2014 consumer inflation accelerated noticeably and amounted 12.0% yoy.

With total budget expenditures growth outpacing revenue, the period's budget deficit stood at about UAH 12.2 billion, which was significantly larger than last year. Despite anticipated improvements in the state budget balance thanks to tough fiscal austerity measures, the overall public sector fiscal balance is forecast to widen, mainly on account of larger Naftogaz (national enterprise servicing fuel and energy complex) imbalances and high expenditures on anti-terrorist operation in Eastern Ukraine.

Meanwhile, banking sector has been weakened by political turmoil and uncertainties, local currency devaluation, deposit withdrawals, a high level of non-performing loans, reduction of foreign capital, and a lack of liquidity. At the same time, in the first month of summer Ukrainian stock market indices for the first time since February 2014 showed a weak trend, changing only by a few percent. The only measure according to which June 2014 for Ukrainian stock market was over May 2014 was the number of profitable investment funds. In June 2014 26 funds have made a profit.

The volume of agricultural production in Ukraine decreased for the first time since the beginning of the year. During January-June 2014 compared with the corresponding period in 2013 it declined by 3.9%. Compared to June 2013 agricultural production in June 2014 declined by 17.6%. However, compared to May 2014 it increased more than twice due to the seasonal factor.

Favorable weather conditions support a positive outlook for this year's crop, despite funding constraints experienced by many farmers during the spring sowing campaign. Although the harvest is likely to be lower than last year's record, thanks to agriculture the economy may perform better in the last quarter of the year.

Political uncertainty, armed confrontation in the eastern regions of Ukraine, hryvnya depreciation, and the announced tough fiscal austerity measures have started to weigh on household consumption and spending, rattled business confidence and undermined investments. In particular, retail sales turnover, often used to gauge private consumption, in June 2014 increased only by 0.8% yoy. At the same time, retail turnover of Ukrainian enterprises during this period declined by 2.1%.

Ukraine's foreign financing concerns started to ease since the end of April 2014, following the IMF board approval of a USD 17 bln two-year loan agreement on the 30<sup>th</sup> of April and the first tranche disbursement in the amount of USD 3.2 bln in the first days of May.

As the IMF loan will also unlock financial assistance from other IFIs and individual countries, the sizable financial aid of about USD 27 bln in total for two years will help rebalance Ukraine's external position.

In the first half of July 2014, the IMF's mission to Ukraine left the country without issuing an official statement and without giving any indication regarding the fate on the remaining tranches of program. The mission

was dispatched to Kiev on June 23 in order to assess the situation and the fulfillment of the conditions previously set by the IMF. Later it was announced that the mission would not leave Kiev on schedule in order to solve the "outstanding issues" with the government. Ukraine's Prime Minister Arseniy Yatseniuk told the press that he expected a positive decision from the IMF. However, the mission silently left Kiev and it seems that the only positive news for Ukraine is that negotiations will continue. Currently, one of the conditions of the IMF program for Ukraine is to regain control of the rebellious eastern regions.

## Anti-terrorist operation in Eastern Ukraine

Since the beginning of March and in April 2014 demonstrations by pro-Russian ultranationalist and anti-government groups have taken place in major cities across the eastern regions of Ukraine, in the aftermath of the Euromaidan movement. Some people in largely Russophone Eastern Ukraine, the traditional bases of support for ex-president Yanukovich and his Party of Regions, did not approve the revolution, and began to protest in favour of closer ties with Russia. Various Russian news media outlets have used the term Russian Spring to describe the wave of demonstrations. Various demonstrations were held in Donetsk, Lugansk and Kharkiv regions in favour of leaving Ukraine and accession to the Russian Federation. Separatists announced creation of self-proclaimed republics (Donetsk People's Republic and Lugansk People's Republic). Later these events have led to armed stand-off between Ukrainian army and Russian mercenary bands. Thus, Ukrainian government had to start anti-terrorist operation.

Despite Moscow's official position providing no ties between Kremlin officials and armed people from Russia, there were numerous facts proving Russia's influence in this confrontation.

On the 12<sup>th</sup> of June, Ukrainian officials reported that three unmarked T-72 tanks had crossed the border into Ukraine and accused the Russian military of allowing the rebels to obtain them. The US reported that the tanks had crossed the border near Snizhne with a convoy of multiple rocket launchers and other military vehicles from a nearby Russian base. NATO released satellite imagery apparently showing ten tanks assembling at the nearby Rostov base, and three later being loaded onto transport trucks. Unmarked tanks were later spotted in Snizhne and Makiivka. US State Department spokesperson Marie Harf said the tanks "were somehow pulled out of the Russian warehouses, someone taught them how to use them, and they were sent from Russia to Ukraine."

On the 14<sup>th</sup> of June, a Ukrainian military transport plane carrying 49 personnel was shot down with a ground-to-air missile as it was attempting to land at Luhansk; initial reports indicate that all 49 Ukrainian service personnel on board were killed.

According to Ukrainian data, 250 civilians were killed in eastern Ukraine since the beginning of the military operations. OSCE observers left Lugansk for security reasons.

In order to avoid human losses and violence escalation the newly elected President of Ukraine brought a proposal of cease-fire.

The President announced a fifteen-point plan for peace on 20 June. The plan called for a week-long ceasefire, starting on 20 June, for the separatists to vacate the buildings they've occupied, for decentralization of power from the central government in Kiev, and for the protection of Russian-language rights.

Russian president Vladimir Putin offered some support for the plan, but called for Poroshenko to bring the separatists into negotiations. Poroshenko previously refused to enter into negotiations with armed separatists. OSCE monitors with the Special Monitoring Mission in Ukraine met with a representative of the Donetsk People's Republic on 21 June to discuss the peace plan. The representative said that the Republic would reject the ceasefire, and said that the primary demands of the government of the Donetsk People's Republic were "withdrawal of Ukrainian forces from Donbass", and recognition of the Republic. However, after initial peace talks between the separatists, Ukrainian and Russian officials, and the OSCE in Donetsk on 23

June, Alexander Borodai, so called prime minister of the Donetsk People's Republic, said that his forces would hold to the ceasefire. Soon after this statement, separatists in Sloviansk shot down a Ukrainian Armed Forces Mi-8 helicopter, killing all those onboard. The next day, the Office of the President of Ukraine issued the statement that said that the ceasefire had been violated by the insurgents at least thirty-five times. President Poroshenko also said that he was considering ending the ceasefire, and Borodai said that "there has been no ceasefire". Despite this, Poroshenko extended the ceasefire by three days from its planned ending on 27 June. In response to this action, protesters in Kiev took the streets in large numbers to demand that the ceasefire be cancelled. The ceasefire had little actual impact on clashes between government and separatist forces, with at least five government soldiers killed during the ceasefire.

A renewed government offensive after the ceasefire broke down resulted in heavy losses for the separatists, forcing them to withdraw from northern Donetsk Oblast, including many cities that had been under their control since April, such as Sloviansk, Druzhkivka, Kostyantynivka, and Kramatorsk.

Currently, the anti-terrorist operation in Eastern Ukraine becomes more successful. The territory occupied by Russian terrorists shortens every day. By the end of June 2014 so called republics controlled only several districts in Donetsk and Lugansk regions. Currently, the most serious challenge lies in possible official invasion of Russian military forces to support pro-Russian militants.

## Ukrainian President signed an Association Agreement with the EU

On the 27th of June Ukraine's President Petro Poroshenko signed a landmark trade and economic agreement with the European Union in Brussels.

Poroshenko said Ukraine had paid "the highest possible price" to sign the free trade agreement with the EU. Calling the measure "historic," he said it was the second most important development in Ukraine following its creation with the 1991 breakup of the Soviet Union.

Georgia and Moldova signed similar deals, holding out the prospect of deep economic integration and unfettered access to the EU's 500 million citizens, but alarming Moscow which is concerned about losing influence over former Soviet republics.

Ukraine's former pro-Moscow President Viktor Yanukovich turned his back on signing the EU agreement last November in favor of closer ties with Moscow, prompting months of street protests that eventually led to his fleeing the country.

Controversy over the agreement lies at the heart of the current crisis and pro-Russian unrest in eastern Ukraine.

The EU-Ukraine Association Agreement is a political and economic cooperation deal that also frees up trade between Ukraine and the 28-member EU. It brings Ukraine one step closer to possible EU membership, and another step away from Russian influence.

The EU-Ukraine Association Agreement calls for a free trade zone and for Ukraine to adhere to European values such as democracy and human rights. It will allow for the country to participate in common border protection and security processes.

In remarks before the signing, European Council President Herman Van Rompuy also remembered those who died in Ukraine.

"In Kiev and elsewhere, people gave their lives for this closer link to the European Union," he said. "We will not forget this."

Van Rompuy said that closer political and economic ties would bring greater security, stability and prosperity to Ukraine and the two other former Soviet states also each signing an EU Association Agreement on Friday, Georgia and Moldova.

"Our joint goal is your full integration into the market of the European Union," Van Rompuy told those countries' three leaders, adding they must push forward with reforms.

He also expressed the EU's solidarity with the three nations in the face of Ukraine's "very difficult" security situation, and the "uncertainties" looming over Georgia's and Moldova's relationships with Russia.

He stressed that Russia had nothing to fear from those nations' closer ties with Europe, adding the EU would engage with Moscow to work for peace.

It should be mentioned that the completion of the association agreement between the European Union and Ukraine marked a severe setback for President Vladimir V. Putin of Russia and his oft-repeated goal of reasserting Russian influence in the "near abroad," Moscow's term for the territories of the former Soviet Union. After agreement signing Russia's Deputy Foreign Minister Grigory Karasin immediately said that this event would have "grave consequences" for Ukraine.

## Russia imposes prepayment for gas supply to Ukraine

On the 16th of June 2014, Russia's energy giant Gazprom decided to introduce prepayment regime with Ukraine's Naftogaz company as a result of a dispute over prices and unpaid debts.

The decision came as Ukraine missed a payment deadline set by Gazprom, which said that from now on it would demand advance payment from Ukraine for any future supplies.

Customers in Europe, who receive Russian gas via pipelines crossing Ukraine, are unlikely to be affected during the summer, but the move raises the threat of supply disruptions in the fall.

The parties of the conflict have different opinions. The Kremlin and Russian gas officials demand that Ukraine settle a USD 4.5 bln debt for past gas supplies and pay USD 385 per 1,000 cubic meters of gas on future deliveries.

They say the price is similar to what Ukraine was paying until last fall and is on par with what Ukraine's neighbors pay for Russian gas.

Ukraine's pro-Russian former president, Viktor Yanukovich, got a much lower price of USD 268.5 per 1,000 cubic meters in December, as part of a Moscow bailout after he ditched a partnership pact with the European Union. Russia canceled all price discounts after Yanukovich was chased from power by protesters in February.

Ukrainian officials do not agree with Russian ones. The government of Ukraine, which depends on Western loans to avoid bankruptcy, says it's willing to pay its gas debt if Gazprom drops the price for future deliveries back down to USD 268.5 per 1,000 cubic meters.

Ukrainian officials claim that price is market-based, even though it's significantly lower than what other European countries pay for Russian gas. Ukrainian state also asks Russia to return USD 6 billion that Kiev overpaid Gazprom because of inflated prices. Currently the state has several months of gas in reserve.

Ukraine accuses Russia of using gas as a weapon to punish it for its intention to integrate into Europe. The gas dispute comes amid a pro-Russian insurgency in eastern Ukraine that flared up after Moscow annexed Ukraine's Black Sea peninsula of Crimea in March.

Ukraine's new leadership said the only way to reach agreement with Russia is to sign a new contract between Russia's Gazprom and Ukraine's Naftogaz with reasonable gas prices. Under the current contract, the price per 1,000 thousand cubic metres for Ukraine is USD 450, which is the top end of the range paid by most of Gazprom's European customers.

While giving his comment on this issue Ukrainian Prime Minister Arseniy Yatsenyuk said "We will not subsidise Russian Gazprom,". "Ukrainians will not pull out of their pockets USD 5 bln a year so that Russia uses this money to buy weapons, tanks, planes and bombard Ukrainian territory."

The Ukrainian delegation is negotiating with the West to obtain reserve gas supplies."If we work together with the EU on the reserve supplies and gas storage, it will radically change the European map of energy safety," Yatsenyuk said. "Russia will stop dictating its own conditions."

This is the third gas dispute between Moscow and Kiev in eight years. Previous disputes with Russia, in 2006 and 2009, led to gas shortages in

Europe because Gazprom uses Ukrainian pipelines for half of its gas flow to the EU.

Energy experts in Ukraine say that Russia is trying to move the negotiations from the economic to the political sphere to gain additional leverage over Ukraine. Currently, it is obvious that Ukraine needs supplies from alternative sources, for example from Azerbaijan.



## International rating agencies continue to monitor the situation in Ukraine

In June 2014, the world's leading rating agencies did not make any changes to the ratings of Ukraine, however, continued to monitor the situation in the country, providing their comments on the specific economic and political developments.

On the 23<sup>rd</sup> of June 2014, Press office of the credit rating agency Standard & Poor's confirmed the long-term credit rating of Kiev at the level of CCC with "negative" outlook.

"Kiev continues to face risks of refinancing, while its internal sources of liquidity are severely limited. We still consider important support from the Central authorities plan to refinance the debt of Kiev in 2014. We reiterate our long-term rating on Kyiv at 'CCC'. The negative Outlook Kyiv same as Ukraine", - stated the credit Agency.

Recall that in February of this year, Standard & Poor's downgraded the credit rating of Kiev from CCC+ to CCC with a forecast of rating fluctuations - "negative."

According to S&P rating scale, rating level CCC provides that obligations may be met in the presence of a favorable business, financial and economic conditions.

Analysts of another international rating agency Fitch Ratings also did not leave Ukraine unattended and expressed their thoughts about Ukraine's government decision to reform the National Joint Stock Company Naftogaz of Ukraine. This reform can lead to the Company's weakening, said the report the Agency's rating which was published on the 10<sup>th</sup> of June.

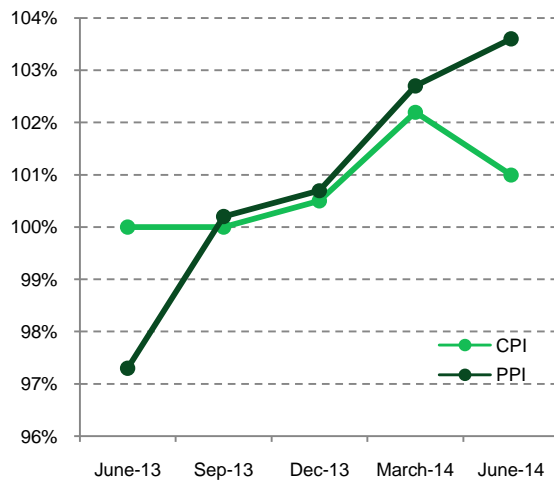
The decision to separate the stable revenues of gas transit from those of gas production and storage reduces diversification and is likely to result in two operationally weaker entities, Fitch notes. The Agency emphasizes that Naftogaz continues to be badly affected by weak operations and cash generation, the ongoing gas price dispute with Gazprom, and the secession of its E&P subsidiaries in the Crimea peninsula.

Another representative of the world's top three largest rating agencies - Moody's - in June 2014 made a mention of Ukraine only indirectly. Moody's ratings agency has cut Russia's outlook to negative, citing the threat to the Russian economy from the Ukraine crisis and a deterioration in Russia's medium-term growth outlook.

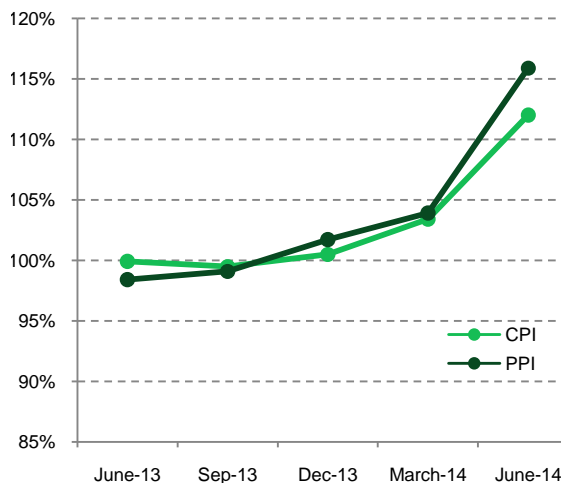
Moody's Investors Service held Russia's overall rating at Baa1 against a background of the country's strong fiscal and external accounts. However, it warned that the spread of the conflict in Ukraine has raised the danger of a "geo-political event risk" for Moscow, including from Western sanctions.

Moody's said in its report that it views the situation in eastern Ukraine as more difficult compared to Crimea, "given the complicated background of separatist forces and the outbreak of violence." The investors service also cited Russia's lower annual growth outlook, which has fallen to 1.7 percent from previous forecasts of three percent over the next five years.

### Hryvnya's de/evaluation, mom



### Hryvnya's de/evaluation, yoy



State Statistics Service of Ukraine

## Inflation dynamics

According to the State Statistics Service of Ukraine inflation in Ukraine during January-June 2014 amounted 5.8% yoy.

Inflation level in Ukraine in June 2014 compared to June 2013 increased and equaled 12.0%. In monthly terms consumer prices also increased. Compared to May 2014 they were by 1.0% larger. At the same time, production prices in Ukraine during June 2014 also showed upward dynamics. In June 2014 production price index equaled 3.6% mom and 15.9% yoy. During January-June 2014 it amounted to 7.0%.

According to the State Statistics Service of Ukraine, in June 2014, compared to June 2013, the consumer price index for food products and beverages increased noticeably and equaled 113.0%. As compared to the January-June 2013 it amounted 6.2%. The most significant increase was recorded in prices for sugar – 58.4% in June 2014.

An 12.0% increase was observed in prices for bread and bread products. In June 2014 prices for meat products rose by 8.8%. Fish products were by 19.4% more expensive. The largest decrease was observed in prices for sunflower oil, which were by 1.2% lower. Prices for cheese were by 11.7% higher and prices for milk increased by 9.9%. Eggs in June 2014 were by 18.1% more expensive, at the same time, prices for butter rose by 15.0%. Fruits in June 2014 were by 24.2% more expensive than in June 2013. Vegetables prices were by 16.7% higher. Prices for non-alcoholic beverages in June 2014 compared to June 2013 increased by 10.9%.

According to the State Statistic Service of Ukraine, prices for alcoholic drinks and tobacco products increased. Thus, in June 2014 they were by 12.8% higher than in June 2013. At the same time, prices for water supply, sewerage and electricity changed very slightly. Prices for maintenance and repair of housing increased by 12.1%. Apartment rent increased by 0.7%. At the same time, hot water and heating prices in June 2014 compared to June 2013 were by 1.6% lower. The largest increase was observed in prices for natural gas, which were by 62.8% higher. Prices for household appliances (furniture, household textiles, appliances) increased by 11.5%, while healthcare prices were by 17.3% higher.

Prices for vehicles in June 2014 were raised by 35.8% compared to June 2013. Transportation as a whole prices in June 2014 increased compared to June 2013 by 26.2%. Prices for fuel and oil rose compared with the previous year by 41.2%. Price indexes for passenger road and railway transport services increased by 13.8% and 15.2%, respectively. During January-June 2014 compared to January-June 2013 transportation prices in general rose by 14.4%.

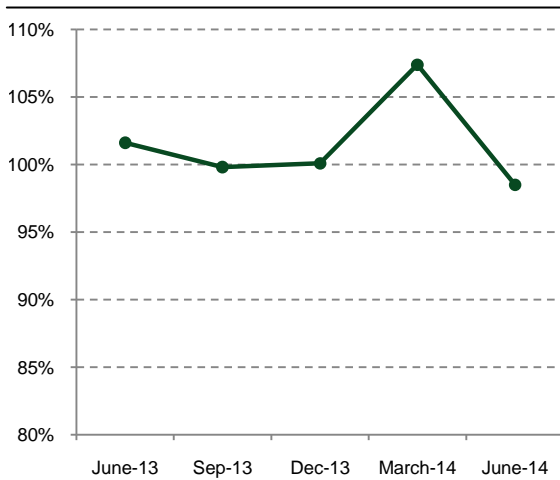
Price index of education services in June 2014 increased slightly compared to June 2013 and was equal to 102.9%. Prices in hotels and restaurants were by 5.8% higher.

It is expected that in 2014 inflation in Ukraine will be significantly higher than in 2013. In May 2014 current Cabinet of Ministers of Ukraine has raised its forecast for increase of consumer prices in 2014 to 16%. Ministry of Economic Development and Trade of Ukraine does not expect further devaluation of Ukrainian hryvnia

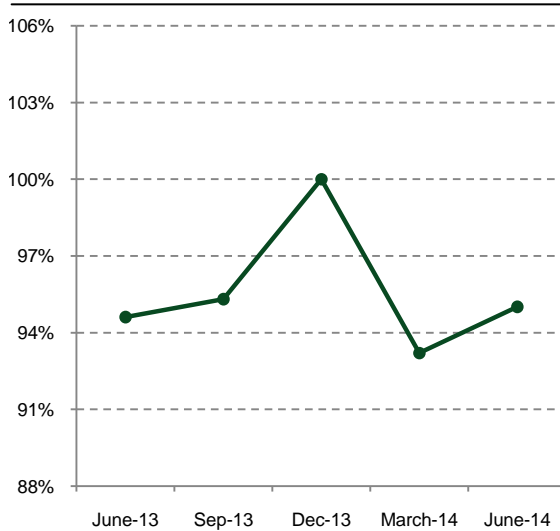
and increase in the rate of inflation during the current year. At the same time, new adopted Head of the National Bank of Ukraine expects inflation at the level of 17-19%.

International institutions have quite the same estimates. The European Bank for Reconstruction and Development expects inflation in Ukraine in 2014 year at 14.4%. The International Monetary Fund forecasts inflation in Ukraine in 2014 at 16%. At the same time, according to the latest estimates, International rating agency Standard & Poor's forecasts 15% inflation in the country.

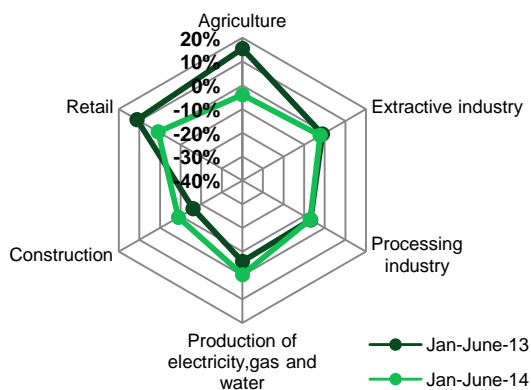
**Industrial production index, mom**



**Industrial output, yoy**



**Industrial growth rate, yoy**



Source: State Statistics Service of Ukraine

**Industrial sector**

Industrial production level in Ukraine in June 2014 was equal to 95.0% compared to June 2013. Thus, in this month industrial production index continued its downward trend which was started since March 2014. Compared to May 2014, industrial output in June 2014 decreased by 1.5%.

Extractive industry in June 2014 decreased by 4.8% yoy. At the same time, mining of coal and lignite decreased by 10.8% yoy, extraction of crude oil and natural gas decreased by 1.8%. Metal ores extraction decreased by 1.6%. Compared to May 2014 extractive industry volume decreased by 2.7%.

At the same time, the volume of processing industry in June 2014 decreased by 5.9% yoy. Production of food, beverages and tobacco increased by 7.1% yoy, the volume of light industry declined by 6.0%. Manufacture of coke, refined petroleum products during June 2014 decreased by 5.3% yoy compared to production volume of 2013. Chemical industry fell by 21.7% yoy. Manufacture of rubber and plastic products fell by 11.3% yoy. Cellulose and paper production, manufacture of wood products decreased by 6.0% yoy. At the same time, manufacture of basic pharmaceutical products and pharmaceutical preparations in June 2014 increased by 14.8% yoy. Metallurgical industry output and machine building fell significantly by 5.6% and 20.8% yoy, respectively.

Compared to May 2014 processing industry in June 2014 decreased by 0.7%. The largest increase compared to the previous month was observed in manufacture of radiological, electrical and electrotherapeutic medical equipment (+448.4 %). The most significant drop was observed in manufacture of railway locomotives and rolling stock (-13.9%).

Production and distribution of electricity, gas and water supply in June 2014 compared to June 2013 decreased by 1.5%. Compared to May 2014 it fell by 2.7%.

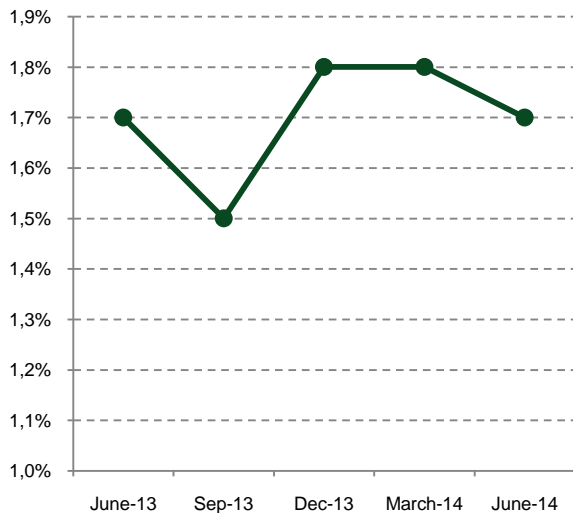
It is also worth noting that the volume of agricultural production in Ukraine during January-June 2014 compared with the corresponding period in 2013 decreased by 3.9%. The output index of agricultural enterprises fell by 7.2%, while private households decreased their production by 1.1%. In June 2014 agricultural production growth was substituted by output decline. Compared to June 2013 agricultural production in June 2014 declined by 17.6%. However, compared to May 2014 it increased more than twice due to the seasonal factor.

Construction in June 2014 decreased by 25.7% yoy. During January- June 2014 it decreased by 8.9% yoy. At the same time, compared to May 2014 construction industry volume fell by 1.5%. Retail in January-June 2014 increased by 0.8% yoy. At the same time, retail turnover of Ukrainian enterprises during this period declined by 2.1%.

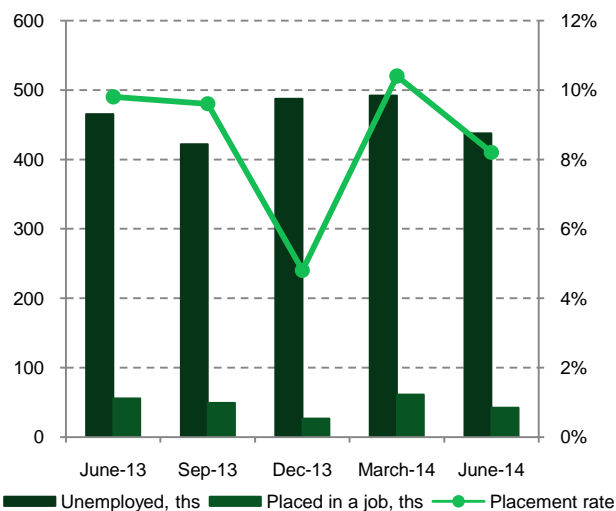
Output reduction in Ukraine's industrial production in January-June 2014 was mainly attributed to falling of the Ukrainian currency and also with the ongoing hostilities in the East of Ukraine. Thus, Donetsk and Luhansk regions were the leaders in industrial production rates reduction. At the saem time. Ukrainian industry also was negatively affected by 20.8% yoy

drop in machine-building and a 21.7% yoy reduction in chemical industry, products of which were traditional for Russian market.

### Unemployment rate



### Labor market figures



Source: State Statistics Service of Ukraine

## Ukrainian labor market tendencies

In June 2014, official unemployment rate in Ukraine didn't change compared to the previous month and was at the level of 1.7%. According to the official data, in June 2014 about 90 persons claimed to 10 jobs. At the same time, this indicator in June 2013 equaled 59.

About 437,5 ths people were registered as unemployed in June 2014 that was by 18.6 ths persons less than in May 2014 and by 67.4 ths persons less than in January 2014. Among 437,5 ths people, 241,4 ths were females and 196,1 ths were males. The share of unemployed women increased to 55.2% during the investigated month and the share of men decreased to 44.8%, respectively (in May 2014 these shares accounted for 54.5% and 45.5% respectively). At the same time, shares of unemployed urban and rural population in June 2014 equaled 64.3% and 35.7%, respectively. In April 2014 shares of unemployed urban and rural population were 63.5% and 36.5%, respectively.

Average unemployment assistance amount in June 2014 equaled UAH 1 145 and was by UAH 16 lower than in May 2014. At the same time, unemployment assistance in June 2014 was obtained by 343.9 ths people, which was by UAH 19.2 ths or by 5.3% less than in May 2014. The enterprises' need for employees was about 48.7 ths people (in May 2014 – 50.6 ths people).

Number of placed in a job in June 2014 equaled 42.5 ths people, which was by 8.2 ths people lower than in May 2014 and by 13.3 ths people lower than in May 2013. Placement rate in June 2014 was equal to 8.2% compared to 9.3% in May 2014.

Official statistic figures representing the state of Ukrainian labor market traditionally do not reflect the actual situation. According to rough estimates of many labor specialists, during January-June 2014 actual unemployment has reached nearly 12%.

Summer job market in Ukraine is experiencing uneasy times: in addition to "dead" business season it remains affected by political crisis and conflict in the East. According to experts, if the situation does not improve in the autumn, at the end of the year unemployment rate could rise from 8.8% (in 1Q2014) to 10% according to the methodology of the International Labour Organization.

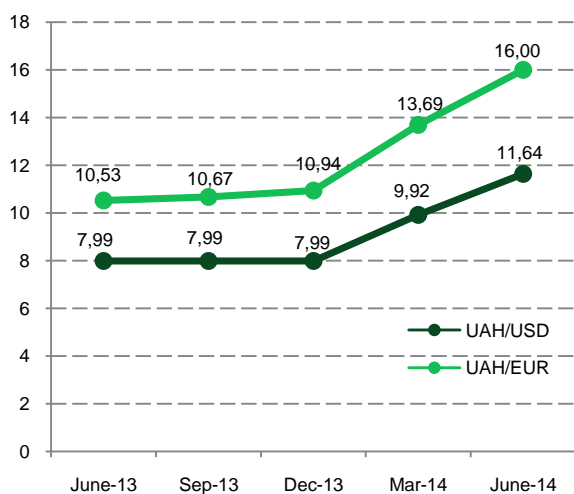
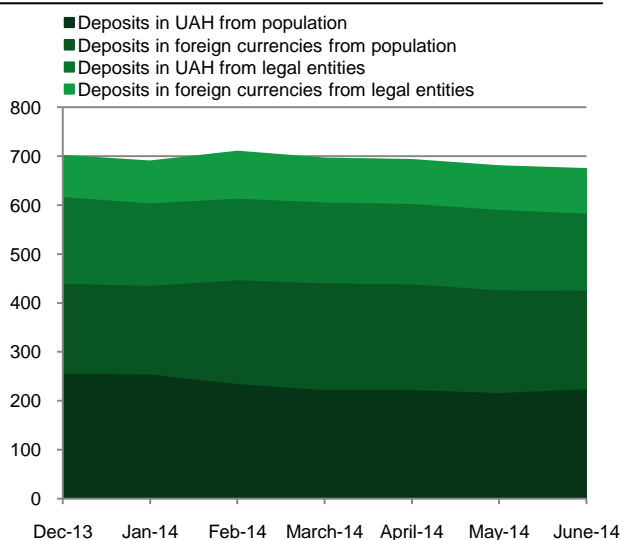
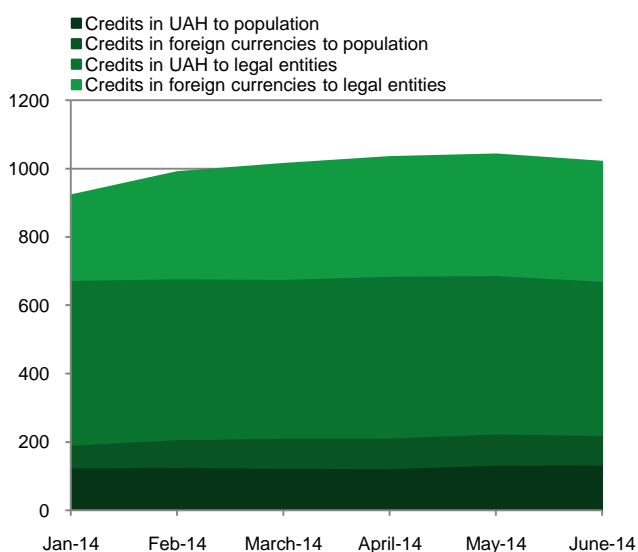
The labor market of Ukraine is currently marked by ambiguous trend. Despite the unstable socio-political situation, the number of registered unemployed in June 2014 decreased. According to experts, the number of vacancies was reduced, and the number of applications was growing. Recently, employers require more knowledge from applicants and people ask the smaller salary.

Applicants from Donetsk and Lugansk regions have the most difficult situation. Because of military actions in these regions, many companies prefer either to reduce the number of employees or to transfer business to another region, choosing as a rule Zaporizhia, Kharkiv, Poltava and Dnipropetrovsk regions. Small businesses often suspend their activities. In cities where military actions are conducted, the number of

vacancies inexorably declines. At the same time, in central offices a reduction is observed in credit, marketing and HR departments. Very often responsibilities are passed on to those who remained.

Nevertheless, IT-specialists remain traditionally popular. They dictate the rules for employers as in previous periods. IT-developers also remain highly paid. The most popular are experts with knowledge of Java, NET, C++, PHP, developments for Android and IOS. Average salary of professional in this sphere is UAH 6-15 ths. per month. Wages growth in this area is not observed, but also there is no reduction. Primarily, this is due to the complexity of qualified staff recruiting.

The lowest number of jobs is offered in production, as well as in legal and construction sectors, where companies apply staffing cuts or payroll optimizations. Since February 2014, many companies started to take unpopular steps. They provide transition to a 2-3-days working week reduction of working hours and vacations without pay.

**Hryvnya's average official exchange rates**

**Bank deposits, UAH bln**

**Bank credits, UAH bln**


Source: National Bank of Ukraine

**Ukrainian banking sector in June 2014**

Ukraine's banking sector remained under stress over April-June 2014, despite the fact that it managed to show positive financial result for the first time since the beginning of 2014. Due to ongoing political unrest and high hryvnya exchange rate volatility, Ukrainian commercial banks kept experiencing deposit outflow. From January 2014 to June 2014, the stock deposits in national currency sank by 9.8%.

Thanks to the NBU's decision to impose limits on foreign currency deposit withdrawals at UAH 15,000 (around USD 1,300 equivalent), the stock of deposits in foreign currency increased by 9.9% yoy in UAH terms for the period. However, total deposits amount in June 2013 was by 2.3% lower than in January 2014 and amounted to UAH 673.0 bln. The NBU continued to provide sufficient refinancing liquidity, simultaneously tightening control over the use of these funds. This, however, did not prevent periodic liquidity shortages and did not affect the availability of bank credit.

The stock of commercial bank loans in local and foreign currency increased by 10.7%. Credits in hryvnya declined by 3.7% and amounted UAH 585.8 bln. Loans in foreign currencies increased by 38.7% and were equal to 432.5 bln.

During January-May 2014 the decline in lending activity was attributed to both the lower ability and willingness of commercial banks to grant credit. Thus, in addition to liquidity difficulties, commercial banks experienced capital outflow and deterioration of their asset quality due to hryvnya devaluation and the economic downturn. However, in June 2014 Ukrainian banks improved their liquidity significantly. According to the NBU data, the ratio of regulatory capital to total assets rose from 15.25% in January 2014 to 15.52% in June 2014.

The structure of Ukrainian banking sector as of 01.07.2014 is represented below:

Item	01.01.14	01.07.14
Number of banks with banking license	180*	174*
Among them with foreign capital	49	51
Including with 100% foreign capital	19	19
Share of foreign capital in authorized capital of banks, %	34.0	32.3
Net assets of Ukrainian banks, UAH bln	1 278	1 307
Financial results, UAH mln	1 436	1 250
Regulatory capital, UAH mln	204 976	187 344

\*- including 1 bank that has a license sanation bank

Source: National Bank of Ukraine

In accordance with IMF requirements, the bank regulator already demanded stress tests for the 15 largest banks. The results, expected at the end of July, are likely to show an increased need in additional bank recapitalization. Several small banks were already put under temporary NBU administration. On the borrowers' side, demand for credit may have also declined amid high lending rates and tight bank credit



requirements.

It is expected that with the IMF program in place, banking sector weaknesses will be addressed, but weak bank lending will contribute to low GDP growth in 2014.

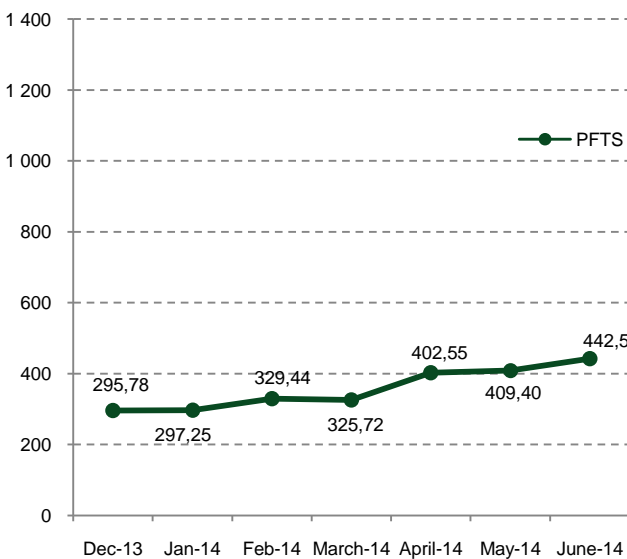
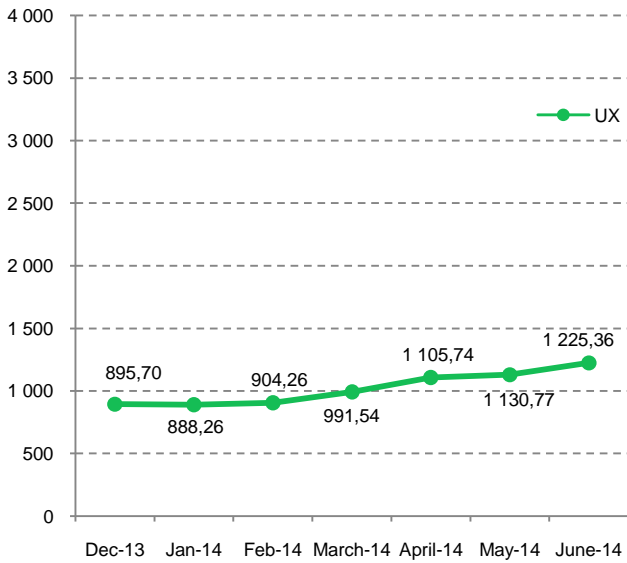
Total assets of the banks since the beginning of the year increased by 3.2% or by UAH 45.4 mln to UAH 1 454.0 mln as of 01.07.2014. Net assets also increased and amounted to UAH 1 307.0 mln. Thus, they were by UAH 28.9 mln or by 2.3% larger than as of 01.01.2014. Structure of net assets was represented mainly by credit operations (75.9%).

Total capital of Ukrainian banks as of July 1, 2014 amounted to UAH 178.4 bln. Registered share capital was equal to 178.3 bln. In the resources structure of Ukrainian banking system the portion of banks' capital amounted to 13.7%.

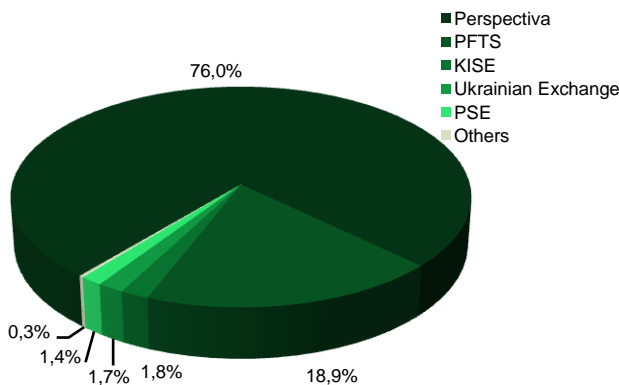
Liabilities of Ukrainian banks as of July 1, 2014 amounted to 1 128.5 bln. They were formed mainly at the expense of population funds (37.2%) and legal entities' funds (20.7%).

Financial results of Ukrainian banks for 6 months of 2014 significantly improved in comparison with the previous periods. The figure was positive and amounted to UAH -1 250 mln. Expenses were equal to UAH 102 120 bln, while incomes amounted UAH 103 370 bln. This resulted in positive indicators of ROA (0.19) and ROE (1.37).

**PFTS, UX indexes**



**Ukrainian Stock Exchanges, trade volume, Jan-June 2014**



**Stock market tendencies**

In the first month of summer Ukrainian stock market indices for the first time since February 2014 showed a weak trend, changing only by a few percent. At the same time, a number of other indicators of the Ukrainian stock market grew slightly compared to May 2014, but they didn't manage to reach the level of the most successful month of the year - April 2014.

In June-2014, the chairman of the board of Exchange Ukrainian Oleg Tkachenko assured that the Ukrainian stock market was ready for growth. This required a positive signal from the outside - for example, diversion of Russian military troops from the Ukrainian border. At the same time, the head of UX noted that activation of the market needed new tools, such as currency futures. Market participants hope that with the change of policy of the National Bank of Ukraine (which is happening now) the regulator will be able to apply these tools and they will be available on the market.

In June 2014, compared with the previous three months, indicators of Ukrainian stock exchanges remained virtually unchanged. Investors were cautious and did not show any excessive optimism and pessimism in relation to the unfolding events in the east of Ukraine, which influenced stock market not only in Ukraine.

Index of Ukrainian Exchange (UX) fluctuated from 1 200 to 1 250 points and by the end of the month decreased by 9.6 points, or by 0.8%. PFTS index during the month was in the range of 440-450 points and decreased by 2.7 points or by 0.6%.

However, in early July 2014 indexes began to decline rapidly. Thus, it is quite possible that in the second month of summer 2014 the situation will be different.

Trading volume at the Ukrainian Stock Exchange in June 2014 increased by 2% compared with May 2014 level, but it was by 3% less than in April 2014. As a result, for the first month of summer, investors reached the volume of UAH 661.85 mln.

Throughout the month (except for the last two trading days) daily trading volume did not drop below UAH 2 mln. In the middle of the month, on the 16th of June 2014 the volume of transactions per day even hit a record of four previous months and reached UAH 9.6 mln.

The futures market of Ukrainian Stock Exchange in June 2014 also demonstrated increase. The number of transactions on the futures market has grown by 25%, while the volume of trade has increased by almost 36%.

The only measure according to which June 2014 for Ukrainian stock market was over May 2014 was the number of profitable investment funds. In June 2014 26 funds have made a profit, in May 2014 there were 20 such funds.

However, the largest indicator of profitability of funds increased from 7% in May 2014 (AMC Dragon Asset Management, Fund Platinum) to almost 12% in June 2014 (AMC Kinto, Fund Equity). However, other investment funds

Source: PFTS, UX, Securities and Stock Market State Commission

in terms of profit per month didn't exceed an indicator of 5%.

## Forecasts

Due to months of political turmoil and related uncertainty, sharp hryvnya depreciation, disrupted trade relations with Russia and tough fiscal austerity measures, Ukraine's real GDP is forecast to decline by about 5% yoy in 2014 (including Crimea). The slight downward revision is attributed to the prolonged unrest in the eastern regions of Ukraine.

Due to above mentioned reasons, many experts have revised public sector fiscal deficit to 7% of GDP for 2014. The worsening of the public finance balance will be mainly attributed to the higher Naftogaz deficit, as the planned increase in natural gas tariffs to the population and heating companies will not outweigh the 43% hryvnya depreciation since the beginning of the year. Moreover, the fiscal deficit forecast may be further revised upwards in case the current negotiations on the price of natural gas imports are unsuccessful.

Meanwhile, the latest estimates of international financial institutions provide Ukraine's GDP decrease in 2014 from 3% to 7%. European Bank for Reconstruction and Development, in its spring survey predicted a fall of Ukraine's GDP in 2014 to 7% amid escalating violence and separatism in the East of the country and economy-wide problems. The International Monetary Fund expects a decline in GDP of Ukraine this year by 5%, while according to the World Bank the country's GDP will decline by 3%.

In July 2014 International rating agency Standard & Poor's forecasted 15% inflation and decrease of the Gross Domestic Product of Ukraine by 7% this year. Inflation in 2014 will amount to 15%, in 2015 – 8%, in 2016 – 7%, in 2017 – 6%, according to the S&P forecast.

At that, Ukraine's economy will contract by 7% this year, in 2015 the GDP growth will be at zero, in 2016 and 2017 economy will grow by 3% and the GDP - by 4%.

Nominal GDP will amount to US \$135 bn in 2014, US \$144 bn in 2015, US \$160 bn in 2016, US \$182 bn in 2017, according to the experts.

It's expected that national budget deficit will amount to 11% of the GDP this year, 7.5% of the GDP in 2015, 5% of the GDP in 2016, 4% of the GDP in 2017.

In addition, S&P is expecting that deficit of the current account of balance of payments in Ukraine will amount to 2.8% of the GDP this year, 4.6% of the GDP in 2015, 5.8% of the GDP in 2016, 5.9% of the GDP in 2017.

The total volume of the national debt will amount to 60.1% of the GDP, 2015 – 62.7% of the GDP, 2016 – 62.9% of the GDP, 2017 - 58.7% of the GDP, according to the experts.