



COUNTRY REPORT UKRAINE: №46



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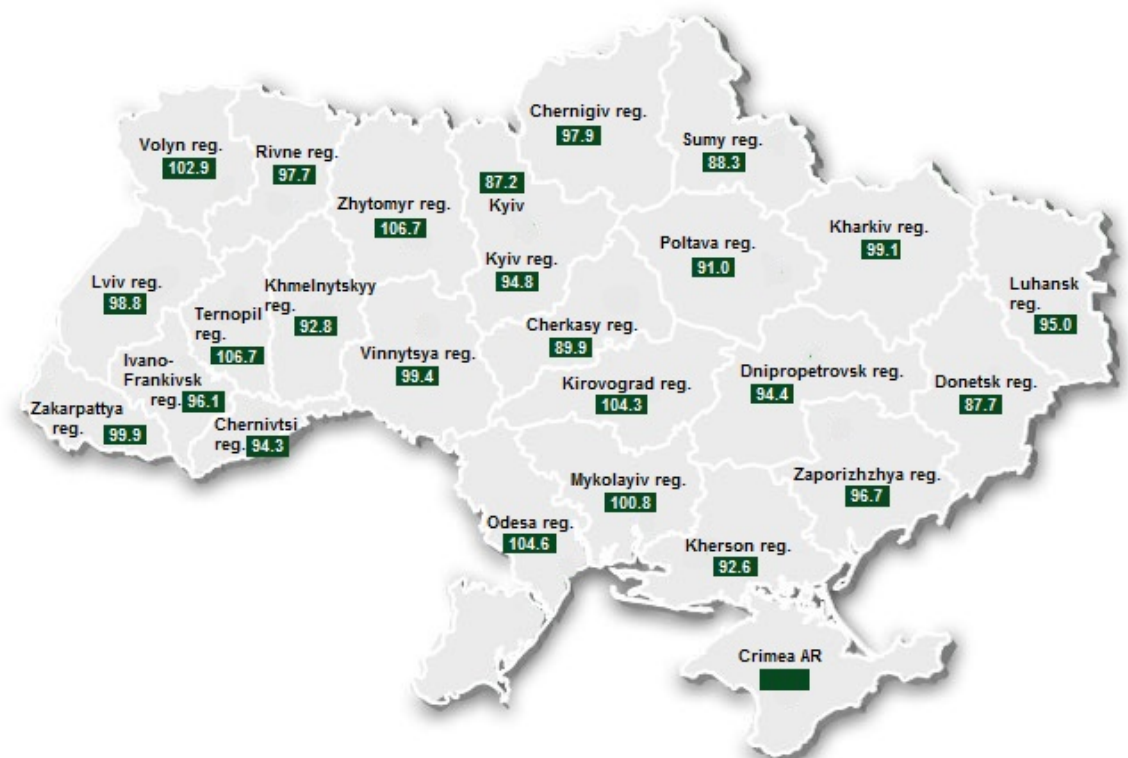
Should you have any comments or questions as for the present report, please feel free to contact the responsible Financial Analyst of the Agency: Evgeniy Savchuk, office@credo-line.com

Main economic tendencies

Economic activity during July 2014 as in previous periods continued to be negatively affected by political unrest, especially in Eastern Ukraine and related uncertainties.

Currently significant improvement in Ukrainian industry performance is not expected. This is due to the fact that there are still factors that contribute to the decline of production. Among them, it is worth noting the situation in the east of the country, the recession in foreign markets and the reduction in domestic demand. Military operation in Donetsk and Lugansk regions not only disrupts the activities of large enterprises, but also breaks production chains. For example, many iron businesses are situated in Dnipropetrovsk and Poltava regions. However, they are directly dependent on supplies from the east. At the same time, the situation on foreign markets also worsens. Since the beginning of the year, prices for Ukrainian products and demand volumes are reduced. In June 2014 exports decreased by 11.6% (to USD 4.4 bln) compared to May 2014. However, trade surplus (USD 43.8 mln) during the first six months was saved. This contributed to the growth of exports of ferrous metals at USD 7.3 bln., crops at USD 3.0 bln. and some other commodity groups.

Domestic demand directly depends on the income of citizens. At the same time, real wages in June decreased by 5.4% compared to the same month last year. Currently, the state does not have resources to stimulate domestic demand. It should be noted that despite all the external factors, the observed decline in production is quite natural. This activity is the most undeveloped in Ukraine. Outdated technologies and equipment have led to a decrease in the share of industrial production in GDP to 25%. For six months of 2014 the decline in industrial production was 4.7%. The largest decrease was observed in Kiev (87.2%), Donetsk (87.7%), Sumy (88.3%), Cherkasy (89.9%), Poltava (91.0%), Kherson (92.6%) and Khmelnytsky (92.8%) regions.



In July 2014 industrial production volume decreased by 12.1% compared to July 2013. Processing industry demonstrated the most rapid decline. In July 2014 it fell by 12.7%. At the same time, extractive industry volume decreased by 12.5% yoy. Overall situation in the industry is supported mainly by pharmaceutical production and food Industry. Work of enterprises in these sectors is less dependent on the political situation and has a stable domestic market.

It is expected that the problems with the gas will hit Ukrainian industry in 2014. In 2013, industrial production consumed 20 bln cbm or 40% of the total. Currently storages have accumulated 14.8 bln. cbm of gas. However, this is not enough for the normal passage of the heating season. It is expected that the supply of gas to industrial enterprises will be reduced by 30%.

Currently, experts and politicians agree on one thing. Until conflict in eastern Ukraine ends it is too soon to talk about positive changes. It is expected that the fall of GDP in 2014 will reach 6-10%, while production will be reduced by 5-10%.

Prime Minister of Ukraine Arseniy Yatsenyuk believes that the next two years for the Ukrainian industry will be severe. "The main task for us now is just to stay afloat. My feeling is that 2016 will be a year of growth," - he said recently.

Agricultural production in Ukraine during January-July 2014 compared with the corresponding period in 2013 increased by 3.4%. The output index of agricultural enterprises rose by 2.8%, while private households increased their production by 4.0%. In July 2014 agricultural production growth was marked by output growth. Compared to June 2013 agricultural production in July 2014 rose by 11.3%.

During January-July 2014 consumer inflation slowed down slightly and amounted 6.8% yoy.

With total budget expenditures growth outpacing revenue, during January-June 2014 budget deficit stood at about UAH 22.7 billion, which was almost the same as in 2013. On the 1st of August 2014, President of Ukraine Petro Poroshenko signed laws on changes to the state budget and the tax code that would increase the revenue side of the budget, reduce the cost of the state apparatus would improve funding needs of Ukrainian Armed Forces.

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.

In July 2014 Ukraine came close to new possible political crisis. On the 24th of July Prime Minister of Ukraine Yatsenyuk tendered his resignation after two parties quit the ruling coalition and parliament failed to support his proposed budget amendments at the first attempt.

Ukrainian Parliament balked at passing budget revisions to spend more money on the war and on reconstruction of shattered infrastructure. However, President Petro Poroshenko urged legislators and the government to find a compromise and keep the parliament working even as he pushed for new elections. Under Poroshenko's prodding, parliament finally passed the bills Yatsenyuk had been pushing.

After approving legislation the Ukrainian parliament rejected Prime Minister Arseniy Yatsenyuk's resignation. This decision was supported

by Ukrainian President. He said that new parliament elections would be “a reality” in autumn 2014.

Political stabilization was very important in terms of further financial support for the country. Ukraine expects that a decision on disbursement of a second USD 1.4 bln tranche of aid by the International Monetary Fund under a USD 17 bln loan programme will be adopted on the 29th of August.

Anti-terrorist operation in Eastern Ukraine

July 2014 started with statement of Ukrainian President Petro Poroshenko, that government forces since the first of July would renew offensive operations against pro-Russian rebels. It happened because of numerous criminal actions of the militants. They publicly declared their unwillingness to support the peace plan as a whole, and in particular the ceasefire. After the President's speech, the ATO (Anti-Terrorist Operation) went into action again. Poroshenko's decision quickly drew fire from Russian President Vladimir Putin who said that Poroshenko had disregarded the advice of Russian, German and French leaders. Putin said that Poroshenko would now have to bear full responsibility for veering off the road to peace. At the same time, according to him Moscow would continue to defend the interests of ethnic Russians abroad up to three million of whom live in the east of Ukraine. Along with this European and American leaders continued to support Poroshenko's move.

In a week after the active phase of ATO, territories controlled by the separatists were half as large. Anti-terrorist forces destroyed militants' fortifications and took control of the village Zakitne, the villages of Stary-Karavan and Brusivka, south of Krasnyy Lyman, Rayhorodok, Rayoleksandrivka and Riznykivka (Slavyansk district). The separatists also left Mykolaivka, Slavyansk, Kramatorsk, Druzhkivka, Kostyantynivka and Artemivsk. As a result of efficient ATO, the self-proclaimed governor of the so-called People's Republic Lugansk Valery Bolotov left Lugansk and arrived in Stakhanov.

During the active phase of the ATO, the terrorists began the process of evacuation from Ukrainian soldiers ridden areas. They aimed to take out from all the accumulated financial resources and weapons. With the bulk of pro-Russian forces fallen back to Donetsk, including the former defenders of Slavyansk, the rebels began to fortify the city and prepare for a stand against the advancing Ukrainian military. Rebels erected new barricades on the streets of Donetsk on the 7th of July.

After that President of Ukraine instructed to provide urgent humanitarian aid to the citizens of Slavyansk and other inhabited localities of the Donbas region liberated from militants. Also, the work on the restoration of energy and water supply was started immediately in order to ensure normal life in the city. United Nations High Commissioner for Refugees supported President of Ukraine and distributed humanitarian aid to the most vulnerable returnees in Slavyansk, Donetsk region.

Since the 10th of July confrontation resumed with renewed vigor. On the same day six pro-Russian tanks and one armored fighting vehicle attacked Luhansk airport, held by Ukrainian forces. At least three bridges were destroyed by rebel forces. All the bridges lead into Donetsk city. Fierce fighting involving tanks, mortar fire and "Grad" rockets was reported around Luhansk's airport during the all stressful days. However on the 14th of July the Ukrainian Army unblocked villages of Metalist, Oleksandrivsk, Bile, Rozkishne from the militants and unblocked the Luhansk airport during high-intensity battles.

Meanwhile, Russia continued to pull its troops to the border with Ukraine, and actively used unmanned aerial vehicles to spy on the positions of the Ukrainian military. This information was given by the State Border Guard Service (SBGS) and reported on official website on the 16th of July.

At the same time, despite the all the negatives about the non-participation of Russia to the military conflict in Ukraine, there were numerous evidences to the contrary. On the 16th of July Gukovo

residents of Rostov region in Russia Federation posted a video of the shelling system "Grad" in Ukraine, located in Russia. At the same time in the Luhansk and Donetsk regions "green men" were spotted, who had no markings. Recall that the Russian annexation of the Crimea was also accompanied by the participation of the "green men".

Since the start of the conflict, several Ukrainian air force aeroplanes have been downed. A few airlines started to avoid eastern Ukrainian airspace.

The most tragic and unexpected event of this unrest happened on the 17th of July when an international passenger plane was crashed near Torez town, 40 km from Russian border. Malaysia Airlines Flight 17 was a scheduled international passenger flight from Amsterdam to Kuala Lumpur. As a result of the tragedy, all 283 passengers and 15 crew on board have died. The crash occurred in the very heart of the conflict zone in Donbass, in an area controlled by the terrorist.

According to the US intelligence sources, the plane was downed by a "Buk" surface-to-air missile fired from the territory controlled by pro-Russian separatists. The conclusion was based on sensors that traced the path of the missile, shrapnel patterns in the wreckage, voice print analysis of separatists' conversations in which they claimed credit for the strike, and photos and other data from social media sites all indicated that Russian-backed separatists had fired the missile. Despite these facts, the Russian government has blamed the Ukrainian government for the shootdown.

On the day of the crash, a meeting was convened of the Trilateral Contact Group. The rebels promised to provide safe access and security guarantees to the national investigation commission by cooperating with Ukrainian authorities and OSCE monitors. However, during the first days of investigation, the militants didn't allow the OSCE and other international observers to work freely at the crash site. According to the Ukrainian government, the separatists were destroying all evidence of the crime "with the help of Russia", including moving 38 bodies to Donetsk.

In rather challenging conditions an international investigation team was examining why the aircraft had crashed. In agreement with the Ukrainian government, the Netherlands led the investigation. On 21 July, pro-Russian rebels allowed Dutch investigators to examine the bodies. It was reported on 21 July that with 282 bodies and 87 body fragments found, there were still 16 bodies missing. An agreement has been reached that the Netherlands will co-ordinate the identification effort. All remains will be moved to the Netherlands. On 30 July, it was reported by a Ukrainian representative that pro-Russian rebels had mined approaches to the crash site and pulled heavy artillery around, making further work by international experts impossible. Later, the Dutch Prime Minister Mark Rutte announced that the recovery operation would be temporarily halted due to an upsurge in fighting around the crash site.

In terms of need for urgent investigation of the tragedy an important issue was concerned with flight data recorders or so called "black boxes". On 18 July, it was reported that the black boxes had been recovered by separatists. On 21 July, the flight data recorder and the cockpit voice recorder were handed over to Malaysian officials in Donetsk by rebels. The Malaysians informed that both recorders were "in good condition". The black boxes are currently being examined at a facility operated by the UK AAIB.

However, through it all, on the 23rd of July, two Ukrainian military jets were hit by missiles at the altitude of 17,000 feet (5,200 m) close to the

area of the MH17 crash. According to the Ukraine Security Council, preliminary information indicated that the missiles came from Russia.

Despite the ultimatum of separatists on the termination of ATO for the admission of international experts to the crash scene of passenger plane MH17, the operation was continued. By the end of July, as a result of effective ATO, Ukrainian military has also liberated Rubizhne, Dzerzhynsk, Soledar, Yuvileyne, Popasna, Siverodonetsk, Karlivka, Netailove, Pervomaiske, Lysychansk, Savur-Mohyla, south of Torez and Debaltseve. Ukrainian President Petro Poroshenko continued to provide humanitarian aid to the war-affected civilian. The territory occupied by pro-Russian terrorists has shortened by 75%. However, the most serious problem currently lies in possible official invasion of Russian military forces to support pro-Russian militants.

Trade relations between Ukraine and Russia have worsened

On June 27, Ukraine signed an association agreement with the European Union, which included the creation of a free trade zone. The European Commission has admitted that the implementation of the rules of the contract may carry out economic risks for relations between Russia and Ukraine. This assumption was confirmed in the July.

During last month, the trade war between Ukraine, Russia and Belarus has reviewed. It started on July, 4th, when Russia imposed the ban on the import of milk and milk products produced in factories of DP Milkland Ukraine. The Health Service identified a discrepancy of Ukrainian cheese with the requirements for fatty acid composition, and also found out the evidence of microbial contamination. Furthermore, on July 11th, the products of Lozovskiy dairy factory were also forbidden on the territory of Russia Federation. As RosPotrebNadzor (The Federal Service for Supervision of Consumer Rights Protection and Human Welfare) stated, discrepancy of the content of milk fat as well as the actual mass fraction of fat listed on the label was identified. At the end of the month Russia decided to restrict the import of whole Ukrainian dairy products. According to RosPotrebNadzor such decision was made because of repeated breakings of Russian veterinary and sanitary requirements. However, indeed such strict sanctions were imposed not because of the quality of products, but because of Russian governments' unwillingness to work with Ukraine after signing an association agreement with the European Union.

Not only Russia started to limit Ukrainian products on its market. On the 10th July Belarus imposed restrictions on the import of potatoes from Ukraine. Such action was performed due to appeal of the Federal Service for Veterinary and Phytosanitary Surveillance of the Russian Federation. The restrictions were taken away on 31 July. However, Ukraine wasn't standing aside. On July, 16th, the Ukrainian government decided to impose higher tariffs on Belarus milk, chocolate and beer. Such measures have been taken in response to discrimination by Belarus in relation to the Ukrainian producers of beverages and food earlier, in June.

Coming back to Ukrainian-Russian relationships, it is important to mention the Ukrainian prohibition of pork imports from Russia due to the outbreak of African swine fever. Finished feeds and feed additives with animal origin, feed of plant origin from Russia have also fallen under the ban. However, this restriction didn't harm the economy as much as the next steps of Russian government in terms of confrontation with Ukraine.

Because of lack of confidence in the work of the State Veterinary and Phytosanitary Service of Ukraine, Russia announced a ban on the import of products from Ukraine in hand luggage on 10th July and since the 28th July, it started to function. Restriction is explained by detected violations during laboratory monitoring of Ukrainian products.

At the end of the month, Russia has imposed a number of restrictions on Ukrainian products. Ukrainian soybeans, sunflower and corn grits, juices and baby food, vegetable, fish, fruit preserves fell under the prohibition of import. Along with these, Russia was planning to raise duties on 130 products as the cancellation of tariff preferences that functioned before.

So July was full of changes in trading relationships between the countries. However, according to the forecasts, some strict restrictions from Ukrainian government in terms of Russian products aren't expected. The authorized of Cabinet of Ministers for European Integration Valeriy Piatnitski stated that Ukraine will not restrict totally the

import of Russian goods in case of similar actions by the Russian Federation. Ukraine will act only within the rules of the WTO and fulfill all its obligations. In addition, Ukraine isn't so much dependent on Russian products and has substitutes for them on national market.

International rating agencies continue to monitor the situation in Ukraine

In July 2014, the world's leading rating agencies have made changes in the ratings of Ukraine, and also have revised their forecasts, while giving comments on the various economic and political developments.

On the 11th of July, 2014, Standard & Poor's rating agency revised its outlook on Ukraine to stable from negative, saying that the International Monetary Fund program adopted in April has helped improve the economic situation in the country.

However, the agency noted that the IMF program could be impacted by geopolitical risks and a severe recession.

"Full disbursement of the International Monetary Fund (IMF) program and related multilateral lending should enable Ukraine to meet its external financing needs over the next year," the ratings agency said in a statement.

At the same time, Standard & Poor's affirmed the 'CCC' long-term foreign currency sovereign credit ratings. Following this Agency also revised its outlook for Ukraine's capital, the city of Kiev, to stable from negative. The 'CCC' long-term issuer credit rating was affirmed, the ratings agency reported.

"The rating action follows our outlook revision on Ukraine on July 11, 2014. The rating on Ukraine's capital, Kiev, reflects our view of Ukraine's institutional framework as very volatile and underfunded," S&P said.

"Other rating weaknesses are the city's severely constrained financial flexibility; weak budgetary performance; weak financial management; weak liquidity; very high debt burden, with associated foreign-exchange risks and high interest payments; and high contingent liabilities," the agency said.

"The rating is supported by the city's position as the administrative and economic center of Ukraine, its fairly diversified economy, and wealth levels that are low, but noticeably exceed the national average," it said.

"The stable outlook reflects our view of the balance between the city's material refinancing risks against our expectation of the central government's support for Kiev's debt refinancing/repayment plan in 2014," S&P said.

In June 2014 another international rating agency Fitch Ratings has downgraded Ukraine-based DTEK Holdings B.V. (DTEK)'s Long-term local currency Issuer Default Rating (IDR) to 'CCC' from 'B-' and affirmed its Long-term foreign currency IDR at 'CCC'.

The downgrade of DTEK's Long-term local currency IDR reflects Fitch's view that its standalone rating is no longer constrained by the Country Ceiling and is commensurate with 'CCC'. This is due to the company's exposure to political and economic instability and uncertainty, which is likely to adversely affect its credit metrics, potential refinancing risk and high FX risk.

Fitch also hasn't remained on the sidelines of the Ukrainian-Russian conflict. In July 2014 it has downgraded the long-term Issuer Default Ratings (IDRs) of 13 Russian banks with foreign stakes to BBB from BBB+ with a negative outlook.

"The downgrade of the banks' IDRs and debt ratings follows the downgrade of Russia's country ceiling to BBB from BBB+," the rating agency said in a statement.

According to Fitch, decreased ratings reflect that sanctions and deteriorating relations with the EU and the United States creates a risk to financial integration of Russia, while increasing the transfer and convertibility risks.

At the same time, in July 2014, the international rating agency Moody's has put on review Russia's sovereign credit rating Baa1. The most likely would be a downgrade by one notch. Also, Moody's will consider the possibility of more serious decline.

Ukraine becomes the third largest grain exporter in the world

Ukraine joined the top three countries that export the largest amount of grain on the world market. It has exported 32.3 million tons of grain during the marketing year 2013-2014, reports Ukrainian Agrarian Confederation. Thus, ahead are just the USA (72.3 mln tons) and the EU (38.5 mln tons). For the marketing year, Ukraine managed to overtake such large grain exporters as Canada (28 mln tons), Argentina (21.9 mln tons) and Brazil (20.1 mln tons).

According to the Ukrainian Agrarian Confederation, the largest amount of whole exported grain was supplied by Nibulon (one of the largest producers of wheat in Ukraine) - more than 4.5 mln tons. That made 14 percent of total grain exports from Ukraine. Among the major exporters were also multinational companies ADM and Louis Dreyfus Ukraine, that have shipped 4.1 mln tons and 3.5 mln tons, as well as Glencore (2,6 mln tons) and Bunge Ukraine (2.5 mln tons). State Food and Grain Corporation of Ukraine took the fifth place (2.9 mln tons), controlling 9 percent of Ukrainian grain exports.

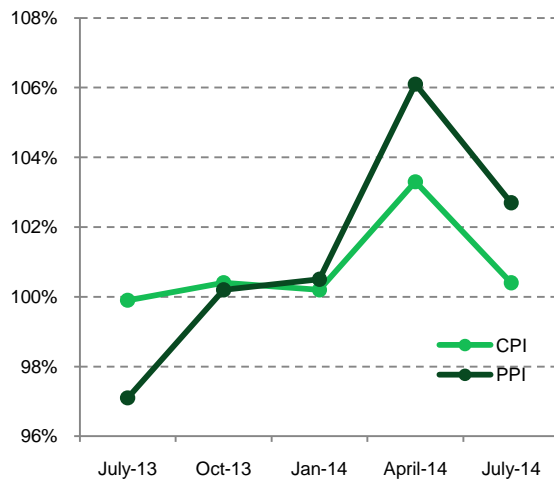
An interesting fact is that, according to the group of companies Grain UA, in the last decade the export of grain from Ukraine increased by 77%. Interagency working group of the Ministry forecasts gross grain production in Ukraine in 2014/15 marketing year at the level 59,1 mln tons, while this figure for the year 2013 was 63 mln tons. The main reason of reduction in the forecast of grain production in the current season is the withdrawal of a volume of grain harvest in the Crimea, while last season this volume was taken into account.

According to the forecast of the Ministry of Economic Development and Trade, with gross grain harvest in the amount of 59.1 mln tons in 2014/15 marketing year Ukraine is planning to export 33 mln tons of grain. This is by nearly 100 ths tons or by 0.3% more than exports amount forecasted last time. The growth in forecast became possible due to the expected increase in gross yield and, therefore, the domestic supply.

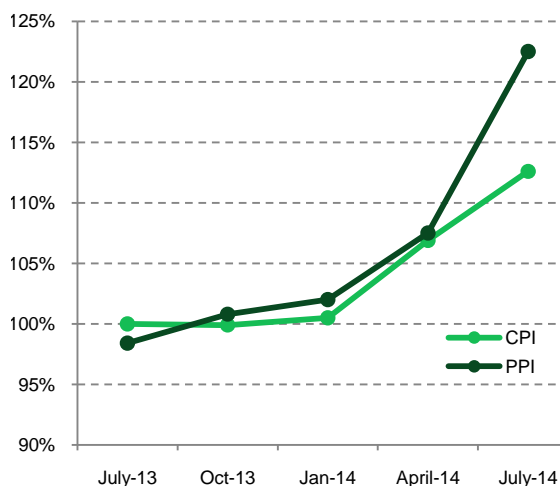
The main export crops in the new season will be traditionally wheat, barley and corn. Thus, the amount exported in 2014/15 marketing year will be about 9.6 mln tons of wheat, 2.4 mln tons of barley and 21 mln tons of corn. Shares of these crops in the forecast total export volume will be about 28.8%, 7.2% and 63.1%, respectively.

At the same time, internal consumption of grain compared to 2013/14 marketing year will decrease by 1.2% - to 25.8 mln tons. Meanwhile food consumption of cereals will be 7 075 mln tons. Compared to the last season, food consumption will reduce by 77 ths tons or by 0.9%. Non-food grain consumption in the new season in comparison with the 2013/14 marketing year will also decrease by 234 ths tons or by 1.2%.

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-July 2014 amounted 6.8% yoy.

Inflation level in Ukraine in July 2014 compared to July 2013 increased and equaled 12.6%. In monthly terms consumer prices also increased. Compared to June 2014 they were by 0,4% larger. At the same time, production prices in Ukraine during July 2014 showed upward dynamics. In July 2014 production price index equaled 2.7% mom and 22.5% yoy. During January-July 2014 it amounted to 9.2%.

According to the State Statistics Service of Ukraine, in July 2014, compared to July 2013, the consumer price index for food products and beverages increased noticeably and equaled 112.5%. As compared to the January-July 2013 it amounted 7.1%. The most significant increase was recorded in prices for natural gas – 62.8% in July 2014.

A 14.0% increase was observed in prices for bread and bread products. In July 2014 prices for meat products rose by 13.1%. Fish products were by 21.1% more expensive. The largest decrease was observed in prices for vegetables, which were by 13% lower. Prices for cheese were by 11.3% higher and prices for milk increased by 10.2%. Eggs in July 2014 were by 20.6% more expensive, at the same time, prices for butter rose by 14.4%. Fruits in July 2014 were by 30.2% more expensive than in July 2013. Prices for non-alcoholic beverages in July 2014 compared to July 2013 increased by 13.9%.

According to the State Statistic Service of Ukraine, prices for alcoholic drinks and tobacco products increased. Thus, in July 2014 they were by 14.9% higher than in July 2013. Prices for water supply increased by 32.5% At the same time, sewerage prices increased by 49.8% and electricity cost increased by 11.3%. Prices for maintenance and repair of housing increased by 13.2%. Apartment rent increased by 0.1%. At the same time, hot water and heating prices in July 2014 compared to July 2013 were by 5.2% higher. 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 12.7%, while healthcare prices were by 18.4% higher.

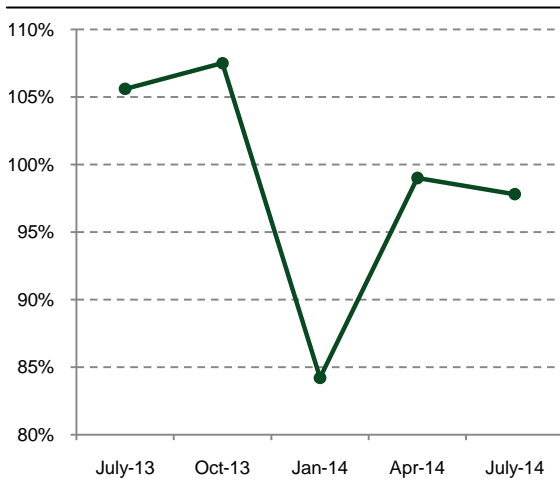
Prices for vehicles in July 2014 were raised by 33.9% compared to July 2013. Transportation prices in July 2014 increased compared to July 2013 by 26.7%. Prices for fuel and oil rose compared with the previous year by 42.6%. Price indexes for passenger road and railway transport services increased by 15.9% and 11.9%, respectively. During January-July 2014 compared to January-July 2013 transportation prices in general rose by 16.2%.

Price index of education services in July 2014 increased slightly compared to July 2013 and was equal to 102.8%. Prices in hotels and restaurants were by 6.9% higher.

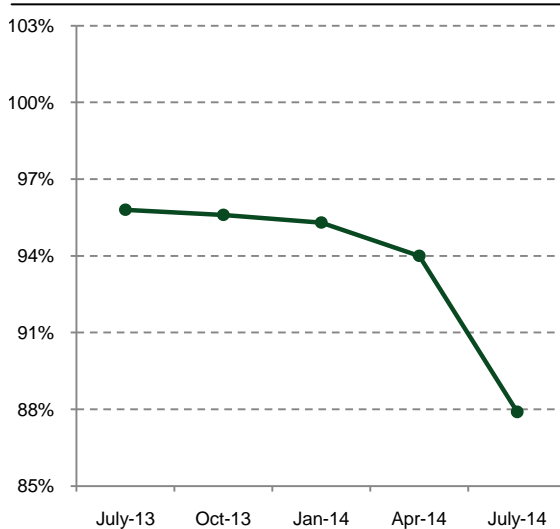
It is expected that in 2014 inflation in Ukraine will be significantly higher than in 2013. In July 2014 Ministry of Economic Development and Trade of Ukraine has raised its forecast for inflation in 2014 to 19%. At the same time, Head of the National Bank of Ukraine expects inflation at the level of 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.

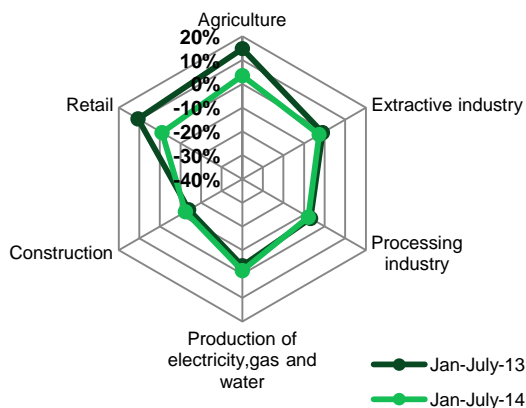
Industrial production index, mom



Industrial output, yoy



Industrial growth rate, yoy



Source: State Statistics Service of Ukraine

Industrial sector

Industrial production level in Ukraine in July 2014 was equal to 87.9% compared to July 2013. Thus, in this month industrial production index continued its downward trend which was started since March 2014. Compared to June 2014, industrial output in July 2014 decreased by 2.2%.

Extractive industry in June 2014 decreased by 12.5% yoy. At the same time, mining of coal and lignite decreased by 28.7% yoy mainly because of hostilities in Donbas region. Extraction of crude oil and natural gas decreased by 1.2%. Metal ores extraction decreased by 6.0%. Compared to June 2014 extractive industry volume decreased by 3.6%.

At the same time, the volume of processing industry in June 2014 decreased by 12.7% yoy. Production of food, beverages and tobacco increased by 3.5% yoy, the volume of light industry declined by 7.5%. Manufacture of coke, refined petroleum products during June 2014 decreased by 15.9% yoy compared to production volume of 2013. Chemical industry fell by 22.2% yoy. Manufacture of rubber and plastic products fell by 13.8% yoy. Cellulose and paper production, manufacture of wood products decreased by 8.1% yoy. At the same time, manufacture of basic pharmaceutical products and pharmaceutical preparations in June 2014 increased by 4.1% yoy. Metallurgical industry output and machine building fell significantly by 12.3% and 13.8% yoy, respectively.

Compared to June 2014 processing industry in July 2014 decreased by 2.4%. The largest fall compared to the previous month was observed in weaving production (+30.8 %). The most significant drop was observed in manufacture of motor vehicles (-43.7%).

Production and distribution of electricity, gas and water supply in July 2014 compared to July 2013 decreased by 7.8%. Compared to June 2014 it rose by 1.9%.

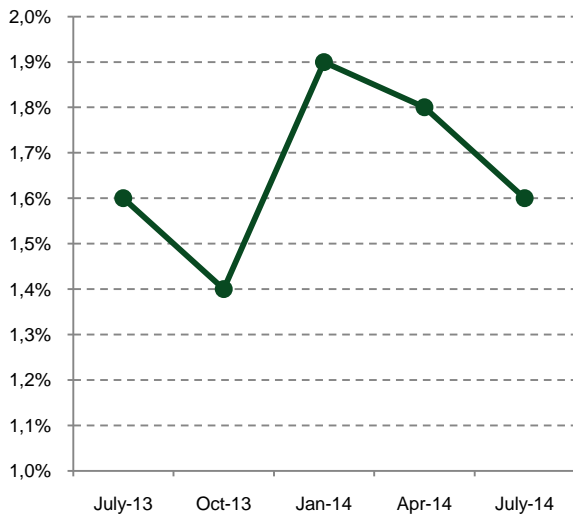
It is also worth noting that the volume of agricultural production in Ukraine during January-July 2014 compared with the corresponding period in 2013 increased by 3.4%. The output index of agricultural enterprises rose by 2.8%, while private households increased their production by 4.0%. In July 2014 agricultural production growth was marked by output growth. Compared to June 2013 agricultural production in July 2014 rose by 11.3%. At the same time, compared to June 2014 it increased more than three times due to the seasonal factor.

Construction in July 2014 decreased by 31.0% yoy. During January-July 2014 it decreased by 12.5% yoy. At the same time, compared to June 2014 construction industry volume fell by 5.3%. Retail turnover in January-July 2014 decreased by 1.0% yoy. Retail turnover of Ukrainian enterprises during this period declined by 3.2%.

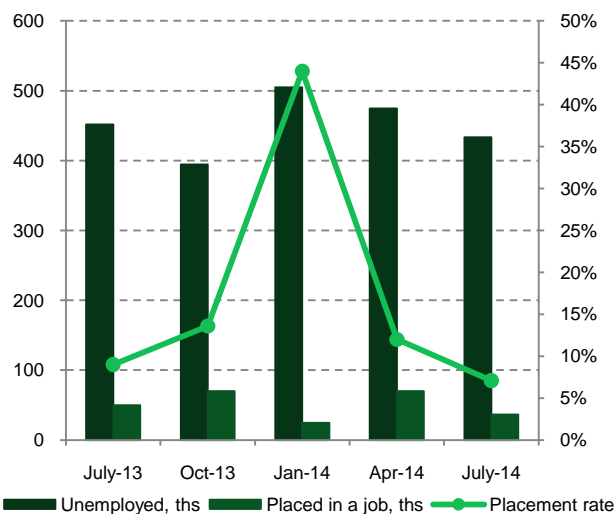
Output reduction in Ukraine's industrial production in January-July 2014 was mainly attributed to falling of the Ukrainian currency and also with the ongoing hostilities in the east of Ukraine. As in previous months Donetsk and Luhansk regions were the leaders in industrial production rates reduction. Currently, regular violence keeps business activities frozen, which results into a stronger decline in industrial output. Conflict-

related demand-side effects are also significant. Many industry development investment projects are delayed.

Unemployment rate



Labor market figures



Source: State Statistics Service of Ukraine

Ukrainian labor market tendencies

In July 2014, official unemployment rate in Ukraine declined slightly compared to the previous month and was at the level of 1.6%. According to the official data, in July 2014 about 89 persons claimed to 10 jobs. In July 2013 this indicator equaled 57.

About 433,5 ths people were registered as unemployed in July 2014 that was by 4 ths persons less than in June 2014 and by 71.4 ths persons less than in January 2014. Among 433,5 ths people, 242,4 ths were females and 190,7 ths were males. The share of unemployed women increased to 56.0% during the investigated month and the share of men decreased to 44.0%, respectively (in May 2014 these shares accounted for 55.2% and 44.8% respectively). At the same time, shares of unemployed urban and rural population in July 2014 equaled 64.3% and 35.7%, respectively. In June 2014 shares of unemployed urban and rural population were 64.6% and 35.4%, respectively.

Average unemployment assistance amount in July 2014 equaled UAH 1 201 and was by UAH 56 higher than in June 2014. At the same time, unemployment assistance in July 2014 was obtained by 342.2 ths people, which was by 1.7 ths or by 0.5% less than in June 2014. The enterprises' need for employees was about 48.8 ths people (in June 2014 – 48.7 ths people).

Number of placed in a job in July 2014 equaled 36.3 ths people, which was by 6.1 ths people lower than in June 2014 and by 13.3 ths people lower than in July 2013. Placement rate in July 2014 was equal to 7.1% compared to 8.2% in June 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-July 2014 actual unemployment has reached nearly 13%.

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

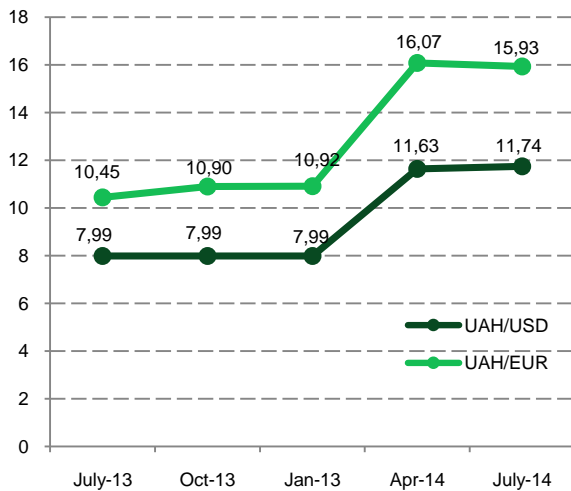
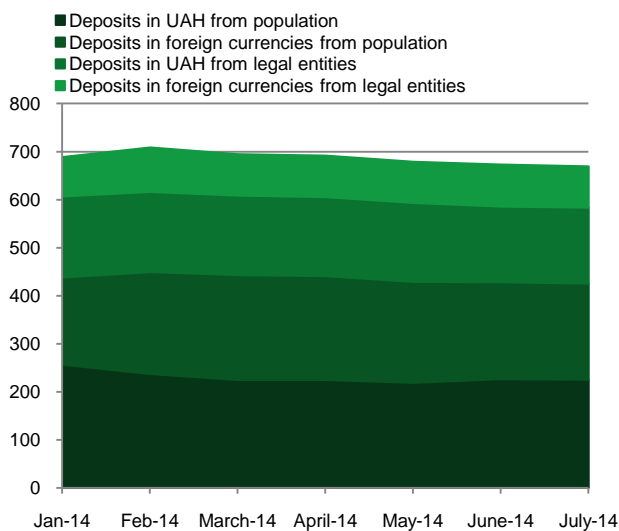
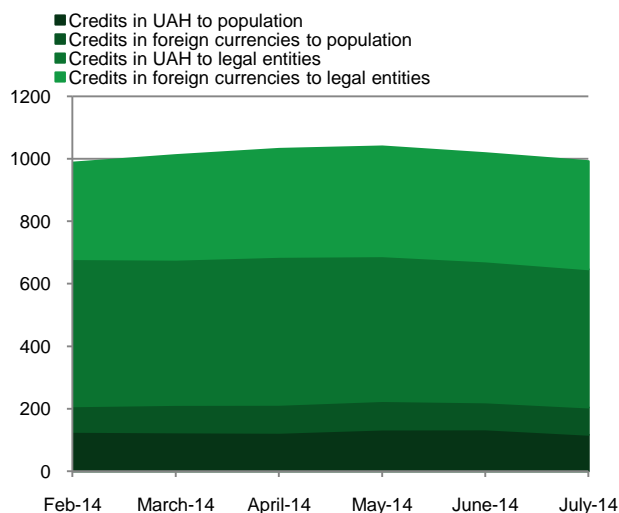
The labor market of Ukraine is currently marked by ambiguous trend. Despite the unstable socio-political situation, the number of registered unemployed in June-July 2014 decreased. According to experts, the number of vacancies was reduced, and the number of applications was growing. Recently, employers 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 industrial 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.

Hryvnia's average official exchange rates

Bank deposits, UAH bln

Bank credits, UAH bln

Ukrainian banking sector in July 2014

Since the start of this year, the situation in Ukrainian banking sector worsened due to the ongoing political and economic crisis. This is reflected in all main banking sector indicators: negative real loan growth; lower credit quality; increased hryvnia costs of servicing foreign currency loans due to the weakened currency; and, based on official National Bank of Ukraine figures, a first-half increase from 7.7 % to 9.9 % in past due loans. This situation, in turn, has caused a decrease in the average capital adequacy ratio of nearly 2.5 percentage points to 15.9 % at present.

Trust in banks also eroded in the first half of the year. After nearly five years of steady growth, retail deposits in local currency decreased by 12 % between January and June 2014.

Moreover, the ratio of foreign currency deposits to total deposits increased by over 5 percentage points, reaching 44 % at the end of June. The NBU has so far managed to support the banks by providing liquidity as needed. Given the current political and security situation, however, uncertainty about the future remains very high.

In July 2014 deposits in national currency decreased. Deposits from population fell by UAH 1.17 bln compared to June 2014 and in July 2014 amounted UAH 225.06 bln. In July 2014 deposits in national currency from legal entities increased slightly. They were by UAH 0.53 bln higher than in June 2014 and amounted UAH 158.03 bln. At the same time, total amount of deposits in foreign currency also showed negative dynamics. In July 2014 deposits from population in foreign currencies amounted UAH 200.08 bln and were by UAH 1.50 bln lower than in June 2014. Deposits from legal entities amounted to UAH 86.03 bln. This amount was by UAH 1.7 bln lower compared to deposits volume in June 2014.

Total amount of loans provided by Ukrainian banks in July 2014 decreased. Credits in national currency to population in July 2014 were by UAH 17.23 bln lower than in June 2014 and amounted UAH 117.51 bln. At the same time, credits in national currency to legal entities decreased in July 2014 compared to June 2014 by UAH 8.79 bln and were equal UAH 442.27 bln. However, credits in foreign currencies to population increased. They were by UAH 0.76 bln larger and amounted to UAH 87.14 bln. Credits volume in foreign currencies to legal entities declined. They were by UAH 0.29 bln lower than in June 2014 and equaled UAH 345.86 bln.

The structure of Ukrainian banking sector as of 01.08.2014 is represented below:

Item	01.01.14	01.08.14
Number of banks with banking license	180*	172*
Among them with foreign capital	49	50
Including with 100% foreign capital	19	19
Share of foreign capital in authorized capital of banks, %	34.0	31.6
Net assets of Ukrainian banks, UAH bln	1 278	1 293

Financial results, UAH mln	1 436	-2 011
Regulatory capital, UAH mln	204 976	184 984

*- including 1 bank that has a license sanation bank

Source: National Bank of Ukraine

Total assets of the banks since the beginning of the year increased by 2.6% or by UAH 36.9 mln to UAH 1 445.6 mln as of 01.08.2014. Net assets also increased and amounted to UAH 1 292.8 mln. Thus, they were by UAH 14.7 mln or by 1.1% 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 August 1, 2014 amounted to UAH 174.2 bln. Registered share capital was equal to 181.4 bln. In the resources structure of Ukrainian banking system the portion of banks` capital amounted to 13.5%.

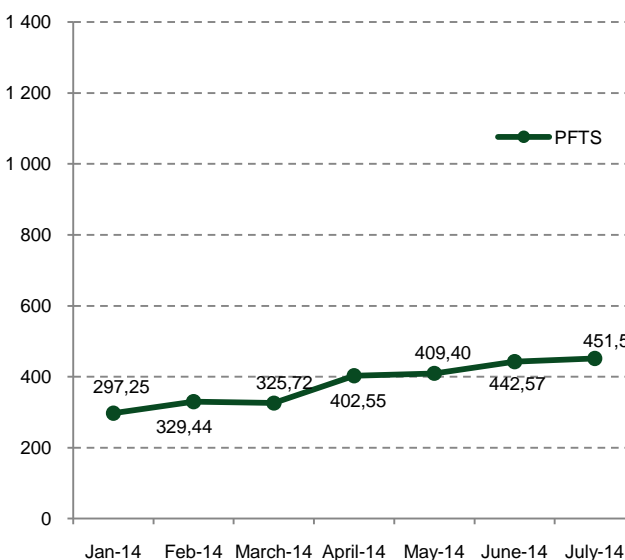
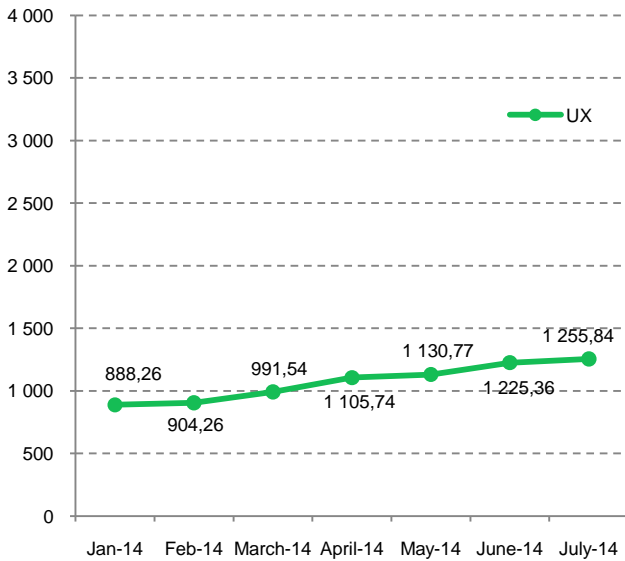
Liabilities of Ukrainian banks as of August 1, 2014 amounted to 1 118.5 bln. They were formed mainly at the expense of population funds (37.3%) and legal entities` funds (21.1%).

Financial results of Ukrainian banks for 7 months of 2014 significantly deteriorated in comparison with the previous periods. The figure was negative and amounted to UAH -2 011 mln. Expenses were equal to UAH 123 417 mln, while incomes amounted UAH 121 406 mln. This resulted in negative indicators of ROA (-0.27) and ROE (-1.90).

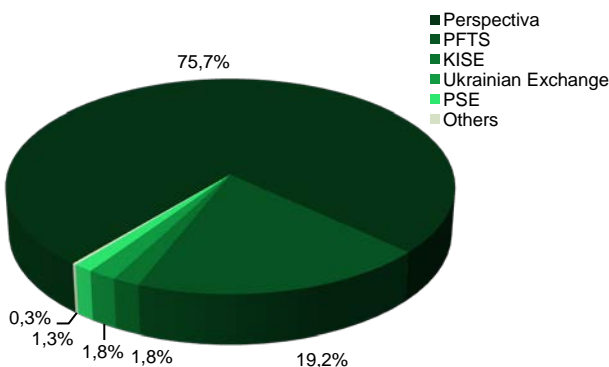
On the 7th of August 2014 the World Bank's Board of Executive Directors approved a USD 500 mln operation to finance the First Programmatic Financial Sector Development Policy Loan to Ukraine. The Loan was designated to support a program of high-priority reform measures in the country's banking sector.

The package of reforms supported by this operation will help improve the performance of Ukraine's banking system and its resilience to both domestic and external risks as well as will strengthen the financial, operational, and regulatory capacity of the Deposit Guarantee Fund.

PFTS, UX indexes



Ukrainian Stock Exchanges, trade volume, Jan-July 2014



Stock market tendencies

In the second month of summer Ukrainian stock market indices continued to show positive trends. At the same time, the volume of concluded stock exchange contracts with securities in Ukraine in July 2014 decreased significantly compared to June 2014.

Since the beginning of the year there was observed an enhanced support for the Ukrainian economy by developed countries that provided financial assistance and opened markets for Ukrainian companies. This had a positive effect on the dynamics of stock market indices. In August 2014 the Cabinet of Ministers of Ukraine made a decision that allowed international financial institutions to carry out transactions on Ukrainian stock market. It is expected that in future periods this decision will bring positive dynamics to Ukrainian stock market.

Currently the most challenging factor that hinders the Ukrainian stock market and keeps foreign investors aside is a military operation in the east of the country. Stabilization in the region will bring a powerful impetus to the stock market.

In July, Ukrainian stock indexes showed a slight increase. Beginning of the month was marked by a continued growth dynamics of PFTS index. On the 29th of July the index reached its maximum value and was equal to 483.34. However, in the last days of the month it began to decline slightly. A similar situation was observed with the UX index. During this month it rose by 10%. On the 30th of July the index reached its highest level - 1 333.43.

The volume of concluded stock exchange contracts with securities in Ukraine in July fell by more than UAH 20 bln or by 37% compared to the same period in 2013. Thus, it equaled UAH 34.8 bln.

According to National Securities and Stock Market Commission, the leaders in terms of trading volumes were stock exchanges Perspectiva with a share of 74.4% (UAH 25.9 bln) and PFTS - 21% (UAH 7.3 bln).

The greatest volume of trading among all financial instruments was recorded in government bonds – UAH 29.5 bln (85% of the total trading volume). A significant portion of total securities transactions also was occupied by enterprises` bonds - UAH 2.5 bln (7.2%) and transactions with shares - UAH 1.4 bln (4%).

The leader of the market - Perspectiva stock exchange in July 2014 organized 1 687 contracts with total amount of UAH 25,91 bln. This was by 7% more than in the previous month.

In July 2014 nearly 20 Ukrainian investment funds received positive financial results. The largest profit was demonstrated by Ataman: Fund promising stocks of Univer Assets Management Company.

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

Forecasts

Threats to Ukraine's political and economic stability continue to increase in step with the escalating crisis in the east of the country. The downing of the MH17 Malaysian Airlines plane in Donetsk on 17 July further increased tensions between Ukraine and Russia.

On 18 July, the IMF released the First Review under the Stand-By Arrangement. The Fund acknowledged that progress had been broadly satisfactory in the implementation of reforms. However, Prime Minister Arseniy Yatseniuk had to undergo a confidence vote on 31 July in order to gain the support necessary to pass crucial bills affecting the budget. Meanwhile, the economy continued to deteriorate. According to a flash estimate, GDP fell 4.7% annually in 2Q2014. The second quarter's GDP rate went down 2.3% compared with the first quarter with due account of seasonal factor.

Taking this into account, the International Monetary Fund (IMF) has worsened Ukrainian GDP falling forecast from 5% to 6.5% in 2014. Meanwhile, Ukrainian Finance Minister Alexander Shlapak said recently that the Cabinet expected a 6-6.5% GDP decline and a 19% inflation rate in 2014. At the same time, the Ministry of economic development and trade expects a 6% GDP fall and a 19% inflation growth.

International rating agencies have almost the same estimates. Thus, In July 2014 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 USD 135 bn in 2014, USD144 bn in 2015, USD160 bn in 2016, USD 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 expects 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.