



COUNTRY REPORT UKRAINE: №47



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**BY CREDO LINE
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Main economic tendencies

Economic activity during August 2014 as in previous periods continued to be negatively affected by political unrest, especially in Eastern Ukraine and related uncertainties. The first half of 2014 Ukraine has finished with 4.6% GDP decrease.

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 Luhansk 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 have been reduced. For the period January-July 2014 exports decreased by 5.3% (to USD 33.4 bln) compared to January-July 2013. However, trade surplus (USD 880.4 mln) during the first seven months was saved. This was caused by significant imports decrease. During January-July 2014 import declined by 20.5% yoy. At the same time, exports of some commodity groups, such as ferrous metals, crops and other food products remained rather high. Crops export increased by 22.3% compared to the same period last year.

Domestic demand directly depends on the income of citizens. At the same time, real wages in July decreased by 2.3% compared to the previous month. 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 Outdated technologies and equipment have led to a decrease in the share of industrial production in GDP to 25%.

Industrial production index in Ukraine in August 2014 was equal to 78.6% compared to August 2013. Compared to July 2014, industrial output in August 2014 decreased by 12.7%. Extractive industry demonstrated the most rapid decline. In August 2014 it fell by 27.4%. At the same time, processing industry volume decreased by 19.2% yoy.

Output reduction in Ukraine's industrial production in January-August 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. The territory controlled by pro-Russian rebels includes a large part of Donetsk coal basin which is the largest in Ukraine. Thus, coal extraction in this region is currently impossible. This results in problems with functioning of thermal power plants, metallurgical production, machine building and many other industries. Destroyed railroads in Donetsk region also make it impossible to transport energy carriers.

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.

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 10-15%.

Agricultural production in Ukraine during January-August 2014 compared with the corresponding period in 2013 increased by 6.3%. The output volume of agricultural enterprises rose by 7.1%, while private households increased their production by 5.6%. In August 2014 agricultural production was marked by significant output growth. Compared to August 2013 agricultural production in August 2014 rose by 13.6%.

During January-August 2014 consumer inflation accelerated slightly and amounted to 7.7% yoy.

With total budget expenditures growth outpacing revenue, during January-August 2014 budget deficit stood at about UAH 35.2 bln, which was by 451.6 mln higher than during the same period of 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. 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.

In late August, 2014 the Executive Board of the International Monetary Fund (IMF) completed the first review of how Ukraine fulfils the economic program backed by the Stand-By Arrangement (SBA) and approved the SBA second tranche worth SDR 914.67 mln (USD 1.39 bln). At the same time, the organization warned about risks loomed ahead as long as Kiev continued to fight a pro-Russian separatist rebellion in the east.

The board also approved a request of Kiev, and combined third and fourth tranches with the aim of getting them this year without changing the total program.

Anti-terrorist operation in Eastern Ukraine

In the beginning of August 2014 Ukrainian military forces and volunteer battalions continued to liberate the territories controlled by terrorists.

Following a series of military defeats, Ihor Hirkin, former insurgent commander for the DPR, urged Russian military intervention, and said that the combat inexperience of his irregular forces, along with recruitment difficulties amongst the local population in Donetsk region had caused the setbacks. He addressed Russian president Vladimir Putin, saying that "Losing this war on the territory that President Vladimir Putin personally named New Russia would threaten the Kremlin's power and, personally, the power of the president".

Government forces began massive attacks in Luhansk and Donetsk cities on 3 August. A number of civilians were killed in fighting in both cities. Luhansk was reported to be "virtually surrounded", with little electrical power or water supply available. The situation in the city of Donetsk was less dire, as trains to Russia were still running, but fighting and shelling did not relent. According to the Armed Forces, at that time, three-quarters of the territory once held by the insurgents had been recaptured. They also said that they had completely cut off supply lines between the so called Donetsk and Luhansk people's republics (DPR and LPR).

On 4 August, the pro-government paramilitary Azov and Shakhtarsk battalions informed that they had advanced into Donetsk city, and had begun to liberate it. The Ukrainian government said that all civilians should evacuate from Donetsk, and issued statements asking DPR and LPR forces to help establish "humanitarian corridors" to allow civilians in Donetsk, Luhansk and Horlivka to flee.

Further skirmishes between insurgents and the Armed Forces took place in Mnohopillia, Stepanivka, Hryhorivka, Krasny Yar, Peremoha, Shyshkove, Komyshe, Novohannivka, ChervonoTalivka, Dmytrivka, Sabivka, and Luhansk airport. Overnight and into 10 August, government forces launched an artillery barrage on Donetsk city, causing "massive damage" across it. According to a spokesman for the Armed Forces, insurgents began to flee the city during the barrage, and were in a state of "panic and chaos". The cities of Pervomaysk, Kalynove, Komyshevakh in western Luhansk region near Popasna, were captured by government forces on 12 August after heavy fighting. Heavy shelling of Donetsk continued into 14 August. During this artillery barrage, Ihor Hirkin resigned from his post as commander of the insurgent forces of the Donetsk People's Republic. He was replaced by Volodymyr Kononov.

Later in the day, a convoy of some two dozen armoured personnel carriers and other vehicles with official Russian military plates crossed into Ukraine near the insurgent-controlled Izvaryne border crossing. NATO Secretary General Anders Fogh Rasmussen confirmed that a "Russian incursion" into Ukraine had occurred. Ukrainian president Petro Poroshenko said that Ukrainian artillery engaged and destroyed a "significant" portion of the armoured column. The defence ministry of Russia denied the existence of any such convoy. Following this incident, the newly appointed prime minister of the DPR Oleksandr Zakharchenko said that his forces included 1,200 Russian-trained combatants.

On the 17th of August 2014 government forces advanced into the edges of Luhansk city. A convoy of refugees from Luhansk was hit by Grad rockets near the village of Novosvitlivka. Dozens of civilians died in the attack, which the National Security and Defence Council of Ukraine blamed on the insurgents.

After having edged into Luhansk city on 18 August, government forces began to advance through the city "block by block" on 19 August. There was also fighting in Makiyivka and Ilovaysk, two cities just outside of Donetsk city. A spokesman for the Internal Affairs ministry said that government forces were "clearing" Ilovaysk of insurgents, and later captured most of the city. The headquarters of the DPR in Donetsk city were also shelled. By early evening on 20 August, government forces said that they had recaptured "significant parts" of the city of Luhansk, after a series of running battles in streets throughout the day.

By 25 August, an insurgent counter-offensive had stalled the government's offensive on Donetsk and Luhansk cities. Insurgents attacked government positions in Shchastya, and along the River Seversky Donets in Luhansk region. As this attack occurred, insurgents in Luhansk received reinforcements. Government forces near Ilovaysk and Amvrosiyivka in Donetsk region became surrounded by insurgents, after their attempt to take Ilovaysk was halted by heavy shelling. The pro-government volunteer Donbass Battalion, trapped in the city for days by the insurgents, accused the Ukrainian government and Armed Forces of "abandoning" them. Other volunteer battalions, such as the Azov and Dnipro, left Ilovaysk after encountering heavy resistance.

DPR forces stated their intention to "fight their way to the Azov Sea" on 23 August. In line with this statement, an artillery barrage rained down on the coastal city of Novoazovsk, in southern Donetsk region. A column of armoured vehicles crossed into Ukraine from Russia near Novoazovsk on 25 August. There were no insurgent formations within 30 kilometres of this area for many weeks. Heavy fighting took place in the village of Markyne, 7 kilometres from Novoazovsk. Insurgents used the village to shell Novoazovsk. A spokesman for the National Security and Defence Council of Ukraine said that the entrance of the column into Ukraine was an attempt "by the Russian military in the guise of Donbass fighters to open a new area of military confrontation". The Dnipro and Donbass battalions repelled the attack, and the "invaders" retreated to the border.

Villagers from Kolosky in Starobesheve districts told mass media that military men with Russian accents and no identifying insignias had appeared in the village at the weekend of 23–24 August. They set up a roadblock near the village. The men wore distinctive white armbands. The villagers referred to them as "polite green men", a term that was used to refer to the irregular Russian forces that took control of Crimea from February 2014. Following the appearance of these men, ten soldiers in green military uniforms with white armbands were detained by Ukrainian forces at Dzerkalne. This village is situated to the north of Novoazovsk, 7 kilometres from Kolosky, and about 20 kilometres from the Russian border. The Russian military confirmed that these men were indeed Russian paratroopers, and that they had been captured. The defence ministry of Russia said the men had entered Ukraine "by mistake during an exercise".

Insurgents pushed into Novoazovsk on 27 August. Town mayor Oleh Sydorkin confirmed that the insurgents had captured it. He also said that "dozens" of tanks and armoured vehicles had been used by the insurgents in their assault on the town. A statement by the National Security and Defence Council of Ukraine (NSDC) later said that Novoazovsk had been captured by "Russian troops", despite earlier denials by the Ukrainian government. According to the NSDC, Ukrainian troops withdrew from Novoazovsk to save lives, and were instead preparing defences in Mariupol.

To the north, close to Starobesheve, Ukrainian forces said that they spotted a column of 100 armoured vehicles, tanks, and Grad rocket lorries that was heading south, toward Novoazovsk. They said these vehicles were marked with "white circles or triangles", similar to the white armbands seen on the captured Russian paratroopers earlier in the week. Amidst pressure on this new third front, government forces retreated westward toward Mariupol. They evacuated the town of Starobesheve and other areas in the 75-kilometre stretch of borderland from the Sea of Azov to the existing insurgent-held territories. Western officials described the new insurgent actions as a "stealth invasion" by the Russian Federation, with tanks, artillery and infantry said to have crossed into Ukraine from Russian territory. US State Department spokesman Jen Psaki said that "these incursions indicate a Russian-directed counteroffensive is likely underway", and Ukrainian president Petro Poroshenko said "An invasion of Russian forces has taken place".

Meanwhile, fighting continued in and around Donetsk city. Donbass Battalion continued to fight against the insurgents that had trapped them in Ilovaysk for days. NATO commander Brig. Gen. Nico Tak said on 28 August that "well over" 1 000 Russian soldiers were operating in the Donbass conflict zone.

The trapped Donbass Battalion withdrew from Ilovaysk on 30 August after negotiating an agreement with pro-Russian forces. According to some of the troops who withdrew from Ilovaysk, DPR forces violated the agreement and fired on them whilst they retreated under white flags, killing as many as several dozen.

A Ukrainian patrol boat in the Sea of Azov was hit by shore-based artillery fire on 31 August. Thus, Ukrainian army finally had to withdraw from several towns in order to concentrate large forces on the defense of Mariupol. This city has a strategic importance. Its capture could allow Russian troops and terrorists to move to the south in the Zaporizhzhya region in order to secure land corridor to the Crimea which had been occupied by Russia in March 2014.

International rating agencies continue to monitor the situation in Ukraine

In August, the world's leading rating agencies assigned new ratings to Ukraine, as well as reviewed some of their predictions, traditionally making comments on the different economic and political developments.

At the end of the month rating agency Fitch downgraded Ukraine's local currency sovereign credit rating from B- to CCC. At the same time, the Agency has affirmed the default rating of issuer in foreign currency at "CCC".

The agency reported that the new Ukrainian government signed an agreement with the IMF and embarked on a series of economic reforms. In addition, in October of this year government elections will be held, which may enhance the support for the program. However, economic and political risks are so high that the effect of innovations in the economy may be quite small.

Analysts expect a decline in real GDP in Ukraine in 2014 at least by 6.5%. They also believe that in 2015 and 2016 in Ukraine there will be no economic growth. At the beginning of 2014, supplies of Ukrainian products to Russia decreased by almost a quarter, and secondly RF reduced gas supplies and Ukraine now may face a lack of energy.

According to the experts, the total budget deficit will reach 10% of GDP by the end of this year. Fitch analysts also noted a significant impairment of hryvnya, which has lost since December 2013 more than 37% against the currency of the United States.

After the sovereign actions regarding Ukraine were carried out the rating agency also lowered local currency ratings of several major Ukrainian enterprises, including the State Administration of Railway Transport of Ukraine.

August 2014 was full of rating actions by S&P with respect to Ukrainian companies. Thus, earlier this month the agency has affirmed the long-term credit rating "CCC" of Ukrainian operator of railway network "UZ" due to increased liquidity risks, maintaining a negative outlook. Also experts of S&P downgraded the rating of agricultural company Mriya Agro Holding to the level of SD ("selective default").

In the middle of the month, analysts of the Agency upgraded the outlook of three Ukrainian banks from "negative" to "stable." It is referred to Alfa-Bank, Credobank and Privatbank. Despite this, the agency reports about increased risks for Ukrainian banks in the matters of funding, liquidity, capitalization and asset quality.

The Agency also improved outlook for the Swiss company Ferrexpo, which controlled in Ukraine Poltava and Eristov Mining and Processing Plants. The Forecast was revised to "stable". In addition, long-term and short-term credit ratings of the company's creditworthiness in foreign and national currencies were confirmed.

At the same time, experts of international rating agency Moody's in August 2014 did not make any changes in their ratings of Ukraine and did not revise the forecasts.

Ukraine gets support for financial sector and receives loan tranche from the IMF

On August 7, 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.

The Loan is 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.

Under the program's framework, the Ukrainian government will provide additional financing to guarantee the reliability of individual deposits, improve the solvency of the banking system and strengthen the legal framework for the long-term sustainability and efficiency of Ukraine's financial sector.

This Loan is part of the World Bank Group's broader crisis-response support package announced in March this year, which aims to provide Ukraine with up to USD 3.5 bln by the end of 2014.

At the beginning of September, 2014 Ukraine has received a loan, according to the information published by the Finance Ministry.

According to a statement at the ministry's website, the 16-year loan carries a seven-year grace period and a floating interest rate, which currently stands at 0.63 percent. The statement also noted that Ukraine is obliged to repay 0.25 percent of the loan as a one-time commission. The loan would be used to improve Ukraine's banking system and implement a comprehensive crisis management program in the country's financial sector, it added.

Ukraine, trapped in political and social turmoil, is teetering on the brink of an economic free fall, with its gross domestic product shrinking by three percent year on year in the first half of 2014.

The country's financial sector is also facing a number of serious challenges that require sustained reforms aimed at boosting Ukraine's strongly affected economic activities.

Such support from the World Bank had a positive influence on the IMF's decision on a second loan tranche provision. According to the Web site of Ukrainian Finance Ministry, Ukraine on September 4 received the second tranche under the IMF program in the amount of SDR 914.7 mln (about USD 1.39 bln). Part of the tranche in the amount of about USD 1 bln will be used to support the national budget," reads the report.

The report notes that the interest rate on the issued credit funds is 3% per annum, and the rate of one-time commission (for reservation of funds) - 0.15% (returned in proportion to the funds received). In addition, the rate of service charge is set at 0.5% of the tranche amount.

The ministry also noted that the repayment of each tranche foresees a grace period of three years (interest is repaid quarterly), and the repayment of the loan principal is made in equal installments on a quarterly basis during two years.

Slovakia Launches Reverse Gas Supply to Ukraine

In August, 2014 Slovakia has started testing a reverse gas flow that aims to help supply neighboring Ukraine with badly needed natural gas.

Slovak company Eustream confirmed on August 16 that a compressor station near the town of Velke Kapushany started pumping gas into the Uzhgorod-Voyany pipeline earlier in the day.

On the 2nd of September, 2014, Ukraine saw first supply of European gas coming through the territory of Slovakia. The maximum volume of such reverse deliveries is estimated at 10 bln cubic meters of gas per year. The Voyany-Uzhgorod pipeline, which became operational on September 2, will allow for gas transportation from the west to the east of the country. The opening ceremony of the pipeline was attended by Ukrainian and Slovak Prime Ministers Arseniy Yatseniuk and Robert Fico respectively.

It is expected that Ukraine will pay about USD 360 per thousand cubic meters for the European gas supplied through Slovakia. "With opening of the reverse supply from Slovakia, Ukraine is getting the opportunity to purchase gas from Europe, we managed to replace 40 percent of gas we previously bought from the Russian company Gazprom with the gas we can now buy and transport from Europe," commented Ukrainian PM during the pipeline opening ceremony in the Slovak city of Velke Kapusany.

Starting September the pipeline will be able to carry up to three bln cubic meters of gas to Ukraine per year; however, by 2015 annual transportation capacities are expected to reach 10 bln cubic meters.

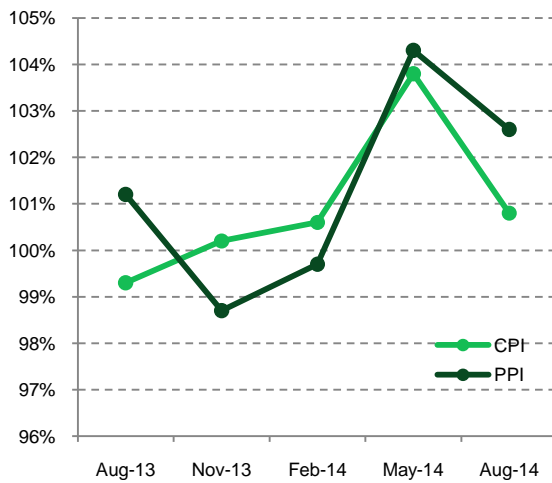
Notably, on April 28, 2014, Ukraine and Slovakia sealed an agreement on the reverse gas supply. It was then expected that reverse gas supplies through this route could only commence in October, however, the pipeline became operational a month early.

Ukrainian officials have been trying to secure European gas supplies through Slovakia for over a year amidst fear of spiking a potential conflict with Russian Gazprom. Ukrainian officials reported earlier that the Slovak corridor for reverse supply of natural gas was the most promising for the country, however, the deal was previously blocked by Russia's Gazprom. Thus, in 2013 Ukraine negotiated cheaper reverse gas supplies through the European countries' territories, such as Poland and Hungary and is still working on reaching respective agreements with Romania.

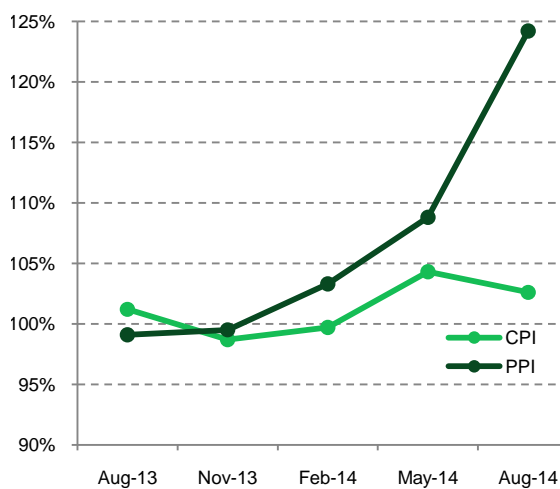
Notably, in May 2014, Ukraine resumed imports of natural gas through Hungary. By late May, Ukraine increased daily imports of natural gas from Hungary by over 100 times: Hungarian operator FGSZ Ltd received an application for the supply of 2.46 mln cubic meters of gas.

In addition to cooperation with its Eastern European neighbors, in May 2012, Ukraine signed a framework agreement with German electric utilities company RWE regarding gas supply. The company agreed to sell Ukraine up to 5 bln cubic meters of gas annually. By the end of 2012, RWE has sold Ukraine 56 mln cubic meters of gas.

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-August 2014 amounted to 7.7% yoy.

Inflation level in Ukraine in August 2014 compared to August 2013 increased and equaled 2.6%. In monthly terms consumer prices also increased. Compared to July 2014 they were by 0,8% larger. At the same time, production prices in Ukraine during August 2014 showed upward dynamics. In August 2014 production price index equaled 2.6% mom and 24.2% yoy. During January- August 2014 it amounted to 11.1%.

According to the State Statistics Service of Ukraine, in August 2014, compared to August 2013, the consumer price index for food products and beverages increased noticeably and equaled 113.9%. As compared to the January– August 2013 it amounted 7.9%. The most significant increase was recorded in prices for sugar – 54.2% in August 2014.

A 16.2% increase was observed in prices for bread and bread products. In August 2014 prices for meat products rose by 14.8%. Fish products were by 22.7% more expensive. The largest decrease was observed in prices for vegetables, which were by 18.6% lower. Prices for cheese were by 11.3% higher and prices for milk increased by 11.1%. Eggs in August 2014 were by 20.6% more expensive, at the same time, prices for butter rose by 13.5%. Fruits in August 2014 were by 41.7% more expensive than in August 2013. Prices for non-alcoholic beverages in August 2014 compared to August 2013 increased by 16.2%.

According to the State Statistic Service of Ukraine, prices for alcoholic drinks and tobacco products increased. Thus, in August 2014 they were by 18.3% higher than in August 2013. Prices for water supply increased by 42.3%. At the same time, sewerage prices increased by 49.8% and electricity cost increased by 60.5%. Prices for maintenance and repair of housing increased by 15.0%. Apartment rent increased by 0.2%. At the same time, hot water and heating prices in August 2014 compared to August 2013 were by 6.4% 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 13.9%, while healthcare prices were by 20.0% higher.

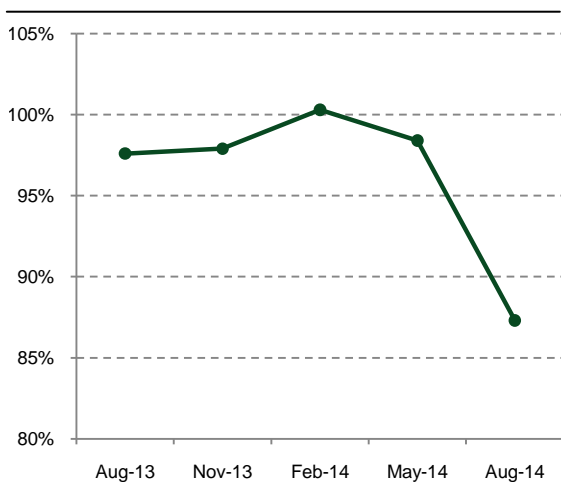
Prices for vehicles in August 2014 were raised by 40.4% compared to August 2013. Transportation services prices in August 2014 increased compared to August 2013 by 18.1%. Prices for fuel and oil rose compared with the previous year by 49.3%. Price indexes for passenger road and railway transport services increased by 17.9% and 17.5%, respectively. During January–August 2014 compared to January–August 2013 transportation prices in general rose by 18.1%.

Price index of education services in August 2014 increased slightly compared to August 2013 and was equal to 102.9%. Prices in hotels and restaurants were by 7.8% higher.

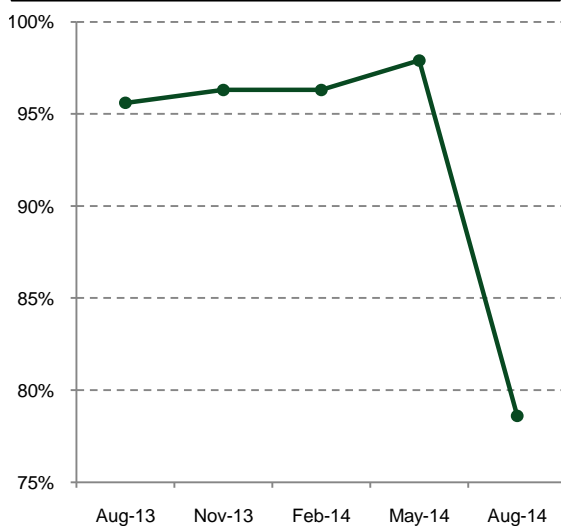
It is expected that in 2014 inflation level in Ukraine will be significantly higher than in 2013. In August 2014 Ministry of Finance of Ukraine has raised its forecast for inflation in 2014 to 19-20%. At the same time, Head of the National Bank of Ukraine expects inflation at the same level. Such opinion was expressed

by Valeriya Gontaryova at Yalta European Strategy (YES) on the
13th of September, 2014.

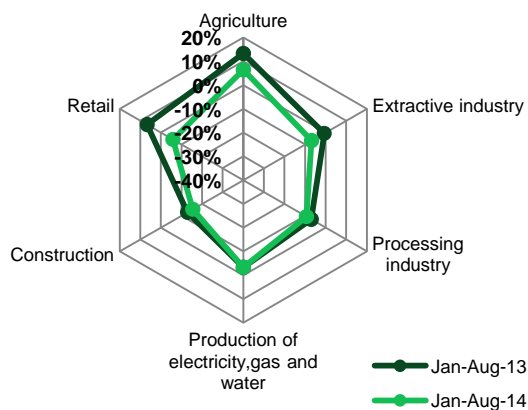
Industrial production index, mom



Industrial output, yoy



Industrial growth rate, yoy



Source: State Statistics Service of Ukraine

Industrial sector

Industrial production index in Ukraine in August 2014 was equal to 78.6% compared to August 2013. Thus, in this month industrial production index has reached the lowest level since the beginning of the year. The index continued its downward trend which has been started since March 2014. Compared to July 2014, industrial output in August 2014 decreased by 12.7%.

Extractive industry in August 2014 decreased by 28.4% yoy. At the same time, mining of coal and lignite decreased by 60.4% yoy mainly because of hostilities in Donbas region. Extraction of crude oil and natural gas decreased by 1.6%. Metal ores extraction decreased by 14.9%. Compared to July 2014 extractive industry volume decreased by 18.1%.

At the same time, the volume of processing industry in August 2014 decreased by 19.2% yoy. Production of food, beverages and tobacco decreased by 0.4% yoy, the volume of light industry declined by 14.2%. Manufacture of coke, refined petroleum products during June 2014 decreased by 50.2% yoy compared to production volume of 2013. Chemical industry fell by 18.6% yoy. Manufacture of rubber and plastic products fell by 14.8% yoy. Cellulose and paper production, manufacture of wood products decreased by 8.7% yoy. At the same time, manufacture of basic pharmaceutical products and pharmaceutical preparations in August 2014 increased by 8.7% yoy. Metallurgical industry output and machine building fell by 30.0% and 31.0% yoy, respectively.

Compared to July 2014 processing industry in August 2014 decreased by 10.2%. The largest increase compared to the previous month was observed in processing and preserving of fruit and vegetables (+64.5%). The most significant drop was observed in mining of coal and lignite (-44.6%).

Production and distribution of electricity, gas and water supply in August 2014 compared to August 2013 decreased by 17.3%. Compared to July 2014 it fell by 12.4%.

It is also worth noting that the volume of agricultural production in Ukraine during January-August 2014 compared with the corresponding period in 2013 increased by 6.3%. The output index of agricultural enterprises rose by 7.1%, while private households increased their production by 5.6%. In August 2014 agricultural production was marked by output growth. Compared to August 2013 agricultural production in August 2014 rose by 13.6%. At the same time, compared to July 2014 it decreased by 15.4% due to the seasonal factor.

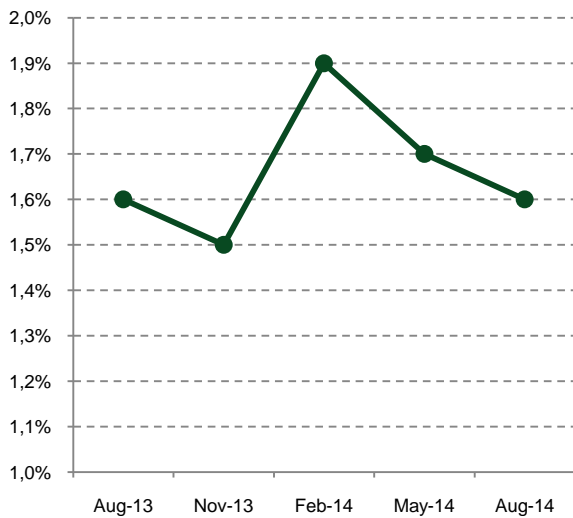
Construction volumes in August 2014 decreased by 37.1% yoy. During January-August 2014 they decreased by 15.6% yoy. At the same time, compared to July 2014 construction industry volume fell by 11.5%. Retail turnover in January-August 2014 decreased by 4.0% yoy. Retail turnover of Ukrainian enterprises during this period declined by 5.8%.

Output reduction in Ukraine's industrial production in January-August 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. The territory controlled by pro-Russian rebels includes a large part of

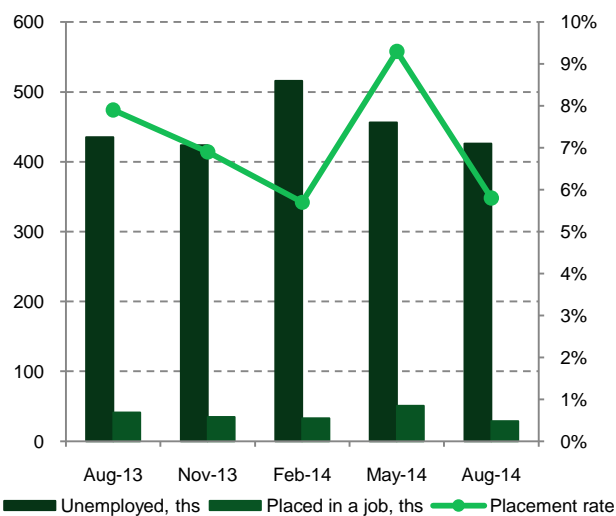
Donetsk coal basin which is the largest in Ukraine. Thus, coal extraction in this region is currently impossible. This results in problems with functioning of thermal power plants, metallurgical production, machine building and many other industries. Destroyed railroads in Donetsk region also make it impossible to transport energy carriers.

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 August 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 August 2014 about 78 people claimed to 10 jobs. In August 2013 this indicator equaled 49.

About 426.1 ths people were registered as unemployed in August 2014 that was by 7.4 ths people less than in July 2014 and by 78.8 ths people less than in January 2014. Among 426.1 ths people, 242.4 ths were females and 183.7 ths were males. The share of unemployed women increased to 56.9% during the investigated month and the share of men decreased to 43.1%, respectively (in July 2014 these shares accounted for 56.0% and 44.0% respectively). At the same time, the shares of unemployed urban and rural population in August 2014 equaled to 65.1% and 34.9%, respectively. In July 2014 shares of unemployed urban and rural population were 64.3% and 35.7%, respectively.

Average unemployment assistance amount in August 2014 equaled UAH 1 185 and was by UAH 16 lower than in July 2014. At the same time, unemployment assistance in August 2014 was obtained by 333.3 ths people, which was by 8.9 ths or by 2.6% less than in July 2014. The enterprises' need for employees was about 54.8 ths people (in July 2014 – 48.8 ths people).

Number of placed in a job in August 2014 equaled 28.5 ths people, which was by 7.8 ths people lower than in July 2014 and by 12.6 ths people lower than in August 2013. Placement rate in July 2014 was equal to 5.8% compared to 7.1% in July 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 15%.

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 Labor Organization.

According to experts, the number of vacancies has been reduced recently, and the number of applications has been growing. Currently, employers as a rule require more knowledge from applicants and people ask the smaller salary.

Applicants from Donetsk and Luhansk 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 Zaporizhzhya, Kharkiv, Poltava and Dnipropetrovsk regions. Small businesses often suspend their activities. In cities involved in military actions 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 highly sought. 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.

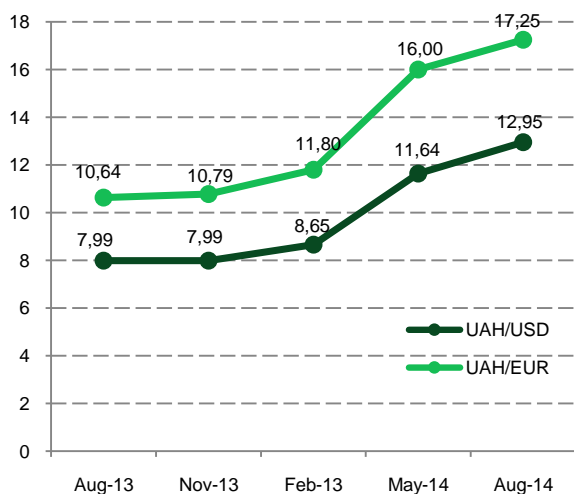
Ukrainian banking sector in August 2014

Since the beginning of this year, the situation in Ukrainian banking sector has 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 hryvnya 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.

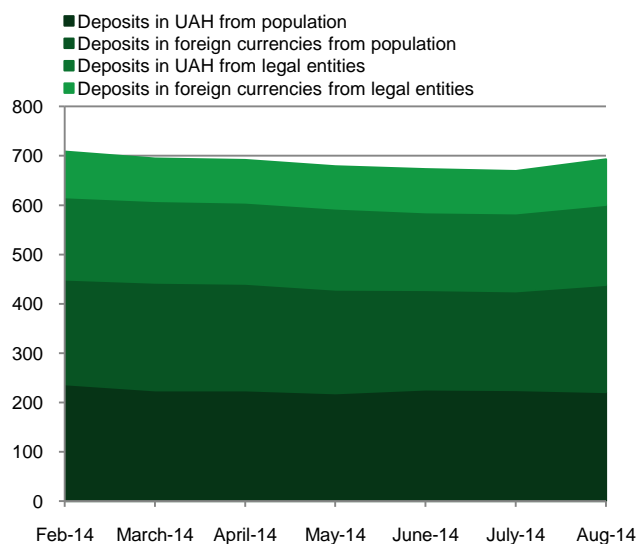
Currently, unlike developed economies, Ukraine's banking sector has a very low degree of concentration. The five largest banks account for about 40% of total banking sector assets. Moreover, the financial crisis has not led to consolidation of Ukraine's banking system, which remains rather fragmented. Many small banks serve as "pocket banks," providing their services exclusively to related companies.

The structure of Ukrainian banking sector as of 01.09.2014 is represented below:

Hryvnya's average official exchange rates



Bank deposits, UAH bln

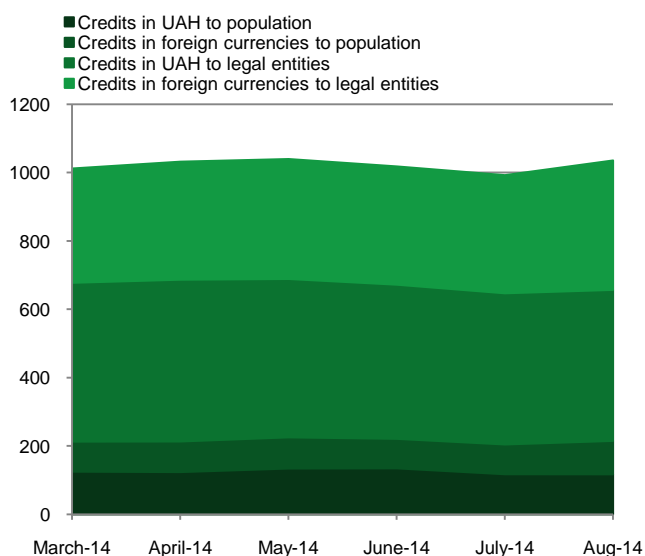


Item	01.01.14	01.09.14
Number of banks with banking license	180*	171*
Among them with foreign capital	49	50
Including with 100% foreign capital	19	19
Share of foreign capital in authorized capital of banks, %	34.0	31.6
Net assets of Ukrainian banks, UAH bln	1 278	1 343
Financial results, UAH mln	1 436	-5 334
Regulatory capital, UAH mln	204 976	185 884

*- including 1 bank that has a license sanation bank

Source: National Bank of Ukraine

Bank credits, UAH bln



In August 2014 the volume of deposits and loans accumulated in Ukrainian banking system increased. At the same time, deposits in national currency slightly increased. Deposits from population fell by UAH 4.08 bln compared to July 2014 and in August 2014 amounted to UAH 220.98 bln. In August 2014 deposits in national currency from legal entities increased notably. They were by UAH 4.16 bln higher than in July 2014 and amounted UAH 162.19 bln. At the same time, total amount of deposits in foreign currency also showed positive dynamics. In August 2014 deposits from population in foreign currencies amounted UAH 217.28 bln and were on UAH 17.20 bln higher than in July 2014. Deposits from legal entities amounted to UAH 92.45 bln. This amount was by UAH 6.43 bln higher compared to deposits volume in July 2014.

Total amount of loans provided by Ukrainian banks in August 2014 increased. Credits in national currency to population in August 2014 were by UAH 0.21 bln lower than in July 2014 and amounted to UAH 117.30 bln. At the same time, credits in national currency to legal entities decreased in August 2014 compared to July 2014 by UAH 0.48 bln and were equal UAH 441.79 bln. However, credits in foreign currencies to population increased greatly. They were by UAH 10.66 bln larger and

amounted to UAH 97.81 bln. Credits volume in foreign currencies to legal entities increased. They were by UAH 33.06 bln higher than in July 2014 and equaled UAH 378.92 bln.

Total assets of the banks since the beginning of the year increased by 6.9% or by UAH 97.5 bln to UAH 1 506.2 mln as of 01.09.2014. Net assets also increased and amounted to UAH 1 343.5 mln. Thus, they were by UAH 65.4 mln or by 5.1% larger than as of 01.01.2014. Structure of net assets was represented mainly by credit operations (75.9%).

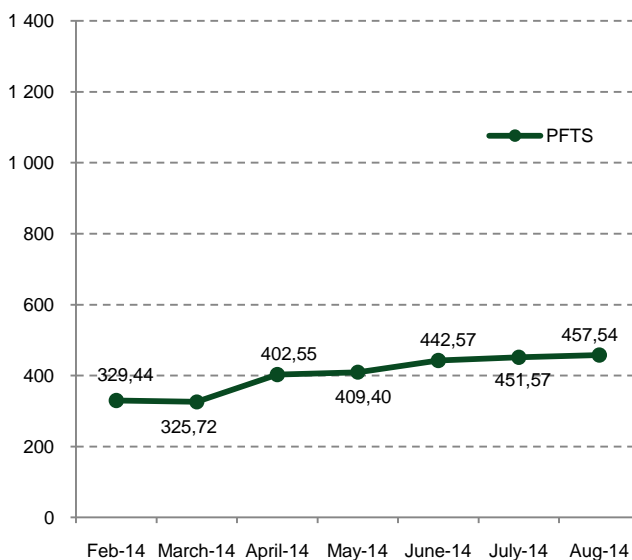
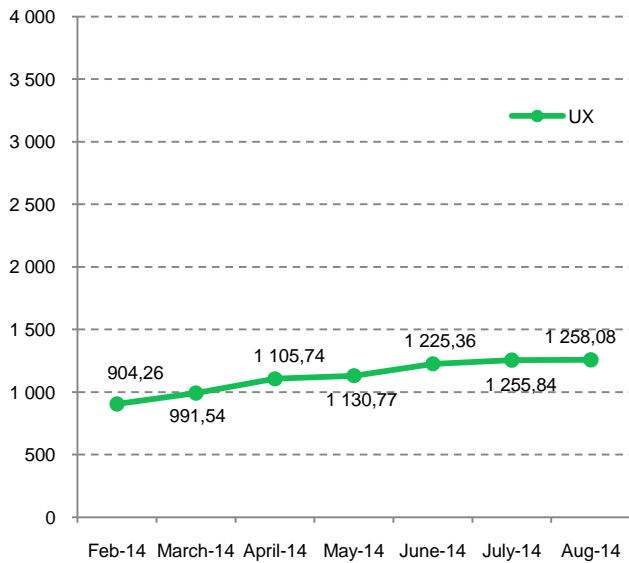
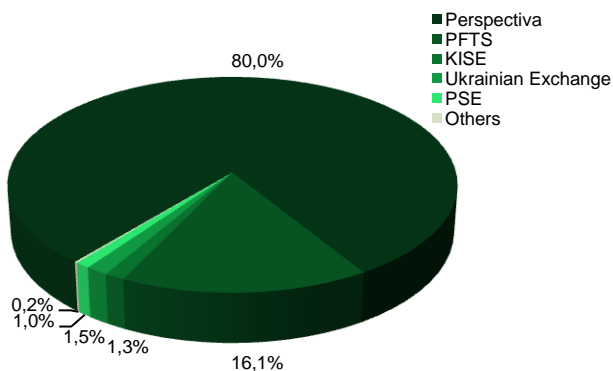
Total capital of Ukrainian banks as of August 31, 2014 amounted to UAH 171.2 bln. Registered share capital was equal to 181.2 bln. In the resources structure of Ukrainian banking system the portion of banks' capital amounted to 12.7%.

Liabilities of Ukrainian banks as of August 31, 2014 amounted to 1 172.3 bln. They were formed mainly at the expense of population funds (36.7%) and legal entities' funds (21.4%).

Financial results of Ukrainian banks for 8 months of 2014 significantly deteriorated in comparison with the previous periods. The figure was negative and amounted to UAH -5 334 mln. Expenses were equal to UAH 146 927 mln, while incomes amounted UAH 141 593 mln. This resulted in negative indicators of ROA (-0.62) and ROE (-4.44).

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-Aug 2014


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

Stock market tendencies

August 2014 was by marked an important event in the Ukrainian stock market. The Cabinet of Ministers of Ukraine allowed the international financial institutions to carry out transactions on the stock market of Ukraine. On the 13th of August, this was stated by Ostap Semerak, the Minister of the Cabinet of Ministers of Ukraine. This is expected to have a positive impact on trade volumes.

Inflow of investment from international issuers will support growth of the market which began after a three-year reduction. Whereas, for private investors this development will bring an opportunity of investment in Ukrainian stock market tools. This will make a significant contribution to the development of Ukrainian economy and make money out of investment.

Meanwhile, the estimated amount of investments involved in the economy of Ukraine through the instruments of stock market during January-August 2014 amounted to UAH 60.04 bln. Compared to the same period in 2013 the volume of investments in the economy of Ukraine through the stock market instruments decreased by UAH 21.38 bln.

During January - August 2014 compared to the same period of 2013 the volume of exchange contracts in securities at stock exchanges increased by 25.91% (or by UAH 78.05 bln), During January - August 2013 this amount was equal to UAH 301.27 bln.

The greatest volume of trading in financial instruments at stock exchanges during the period was recorded with:

- Government bonds of Ukraine - UAH 336.76 bln (88.78% of the total amount of exchange contracts at stock exchanges during January - August 2014);
- Corporate bonds - UAH 21.82 bln (5.75% of the total amount of exchange contracts at stock exchanges during January - August 2014).

The volume of exchange contracts with securities at stock exchanges in the secondary market amounted to 96.41% of the total volume of exchange contracts during the period.

According to National Securities and Stock Market Commission, the leaders in terms of trading volumes during January-August 2014 were stock exchanges Perspectiva with a share of 80.0% (UAH 303.4 bln) and PFTS – 16.1% (UAH 61.1 bln).

In August 2014 Ukrainian stock market indices demonstrated negative dynamics. However their weighted average value was in this month was higher than in July 2014. Thus, average value of PFTS index in August 2014 was equal to 457.5, and was the largest since the beginning of the year. UX index amounted 1 258.1. This was a peak of the index in 2014. The highest results were observed at the beginning of the month. On the 1st of August 2014 PFTS index equaled 472.2 and UX index amounted 1 318.4.

The most challenging factor that hindered the Ukrainian stock market and kept foreign investors aside in August 2014 was a military operation in the east of the country. Stabilization in the region would bring a powerful impetus to the stock market.

In August 2014 only 12 Ukrainian investment funds received positive financial results. The largest profit was demonstrated by OPT Currency of OTP Capital Assets Management Company. It showed a 17% growth. The most significant decline (-21.5%) was demonstrated by Delta-Balanced Fund of Delta-Capital Assets Management Company.

Forecasts

The European Bank for Reconstruction and Development has downgraded the forecast of development of the Ukrainian economy.

Thus, the GDP of Ukraine will decrease by 9% in 2014, while in May the bank predicted the GDP decrease at the level of 7%, according to the EBRD publication as of 18.09.2014.

The bank specified that the forecast is based on the fact that Ukraine has not reached the agreement on renewing gas supply with Russia. "Ukraine will face enormous difficulties without gas supplies from Russia when the winter comes," noted the bank.

In addition, the EBRD expects the declining of the Ukrainian economy by 3% in 2015.

The European Bank for Reconstruction and Development (EBRD) has also slightly revised down its growth forecasts for Central and Eastern Europe, warning that the Ukraine crisis could have a long-lasting effect on the region.

At the same time, the Cabinet of Ministers of Ukraine expects better figures. The Government of Ukraine predicts a fall of GDP by 6% in 2014, can be changed by the growth of 2% in 2015 – said Finance Minister Oleksandr Shlapak at a government meeting on the 15th of September, 2014. "Minus 6% it would be a good result before the end of the year" – he said.

According to Shlapak, the average annual inflation in 2015 is projected at the rate of 13%.

The Minister said that the government planned two scenarios of macroeconomic situation: considering reforms and without significant changes in the current legislation.

The Head of the National Bank of Ukraine Valeriya Gontareva earlier this month stated that experts from the International Monetary Fund downgraded the outlook for the fall in gross domestic product (GDP) of Ukraine in 2014 of the last agreed value of 6.5%. According to her, the program "stand by" of the IMF suggests deterioration in the near future, however, gives the answers to the question how to act in such a case.