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UKRAINIAN ECONOMY: challenges and growth points

GDP: catching up

Ukrainian GDP is still to catch up with its pre-independence level. The drop in GDP caused by the 2008 crisis may be eliminated in 2013.

Chart 1. GDP since the independence

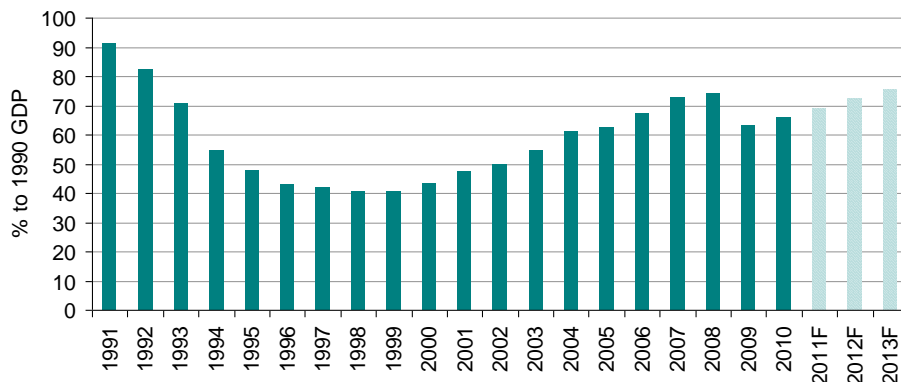
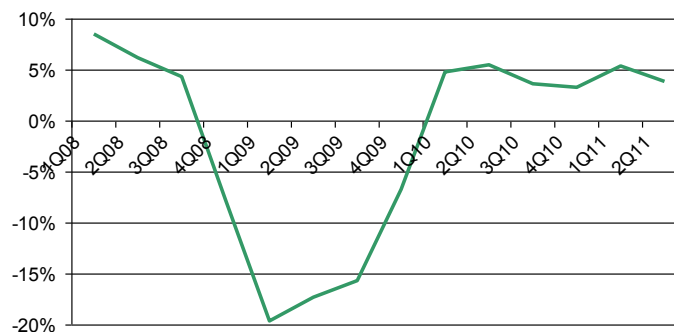


Chart 2. GDP since the crisis, y/y



Source: State Statistics Service of Ukraine, BNP Paribas forecasts



Ukrainian economy: a diverse and very open one

Ukrainian economy being very open is not very well protected from external shocks. On the positive side, it is quite diversified.

Chart 1. GDP by sectors in 2010

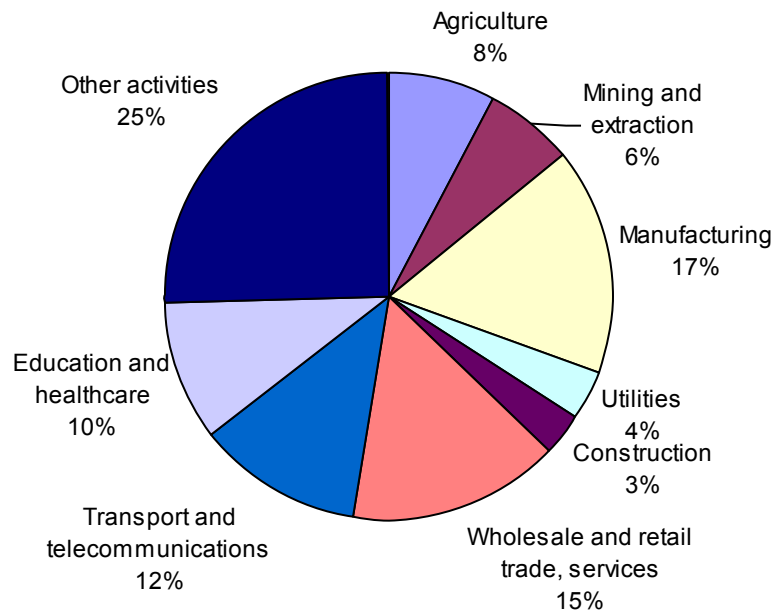


Chart 2. Imports and exports as % of GDP



Source: State Statistics Service of Ukraine



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Ukrainian economy: inflation, BoP and FX

Although consumer inflation has been contained in single digits, the current account has been widening since 2009.

Chart 1. Inflation contained

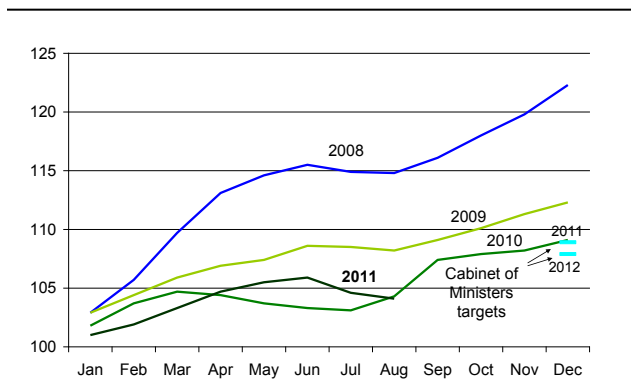


Chart 2. Trade balance

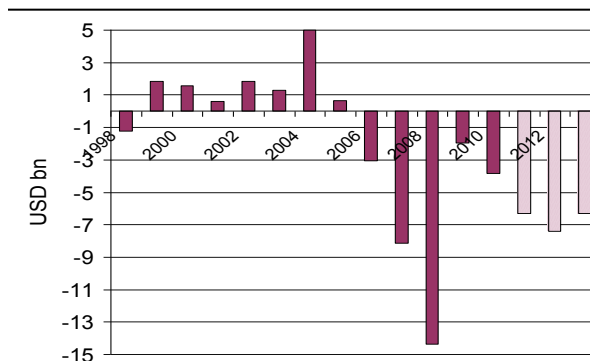


Chart 3. BoP and FX

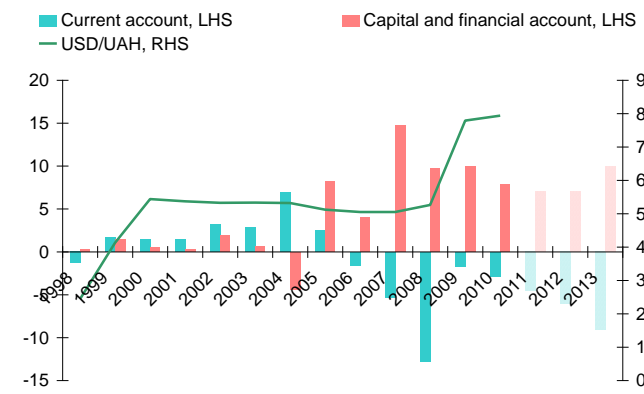
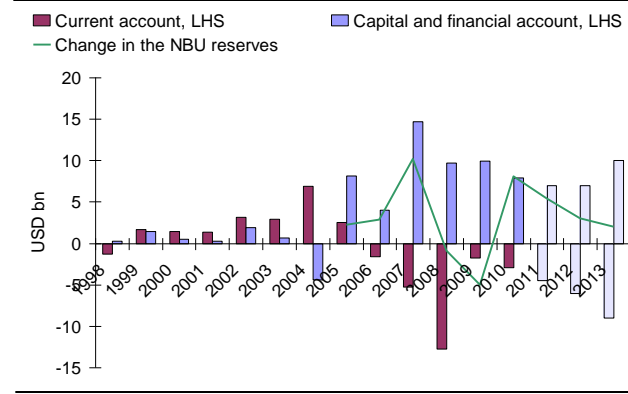


Chart 4. BoP and NBU reserves



Source: SSSU, NBU, IMF, BNP Paribas and UkrSibbank forecasts



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Steel and agriculture: major items of Ukrainian exports

Ukrainian exports (and the national currency) are extremely sensitive to the world's commodities markets.

Chart 1. Ukrainian exports: steel and agriculture

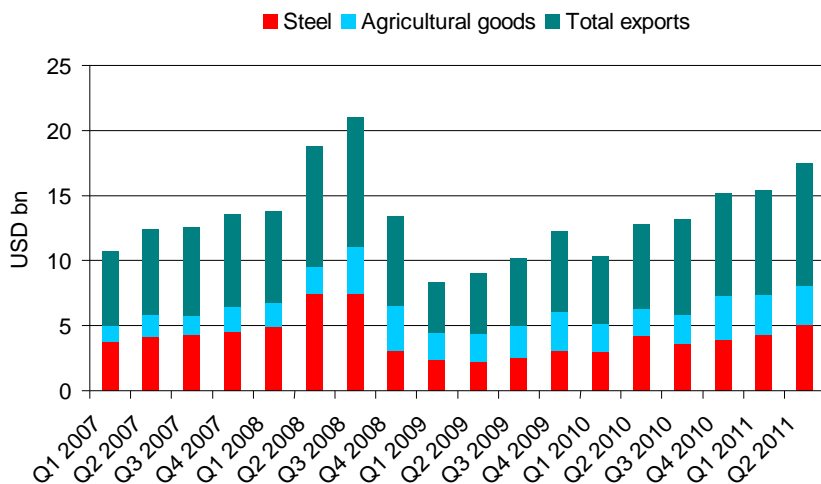
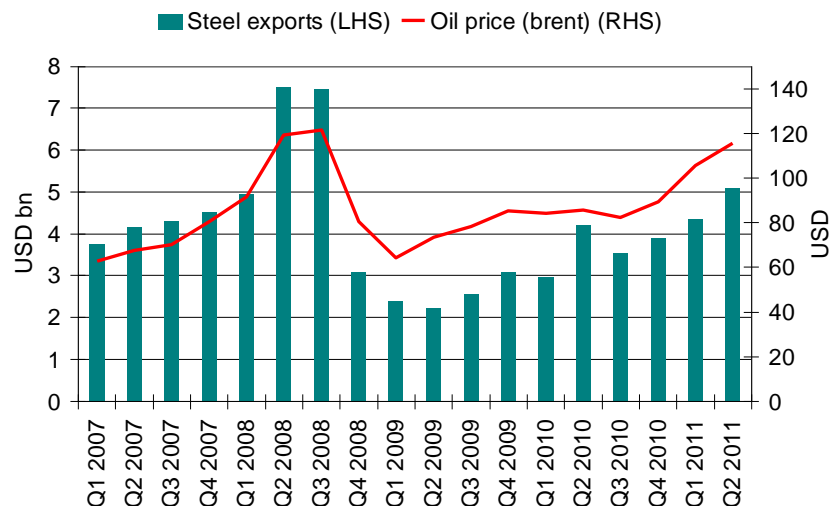


Chart 2. Steel exports: correlation with Brent (!) with a visibly high beta



Source: State Statistics Service of Ukraine, Bloomberg, Steel Business Briefing



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Challenge 1: electoral democracy and need to reform

The country is in dire need for reforms, but the electoral democracy suggests populist economic policies (no tariff hikes, stable UAH, etc.)

Chart 1. Electricity tariffs for households and businesses, EUR/kWh

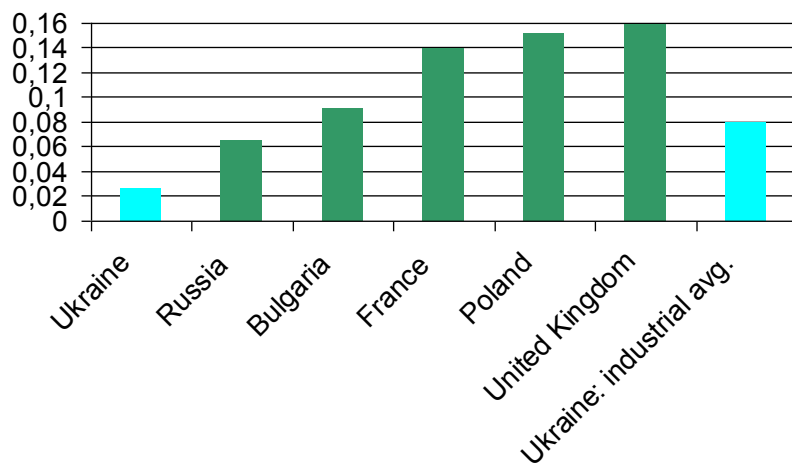
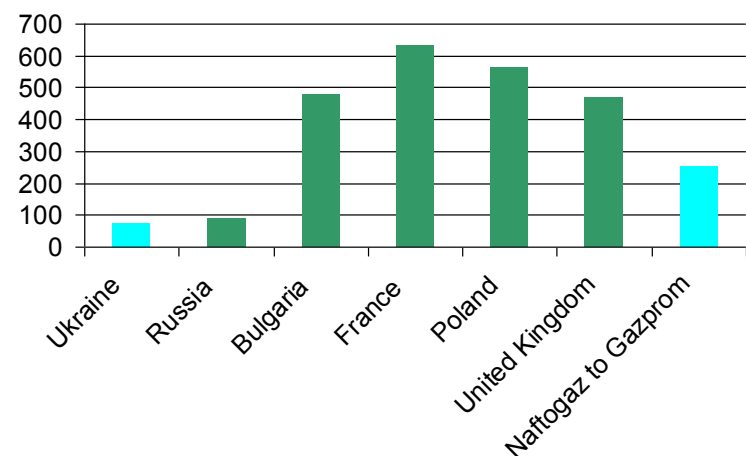


Chart 2. Natural gas tariffs for households, EUR/000 m3



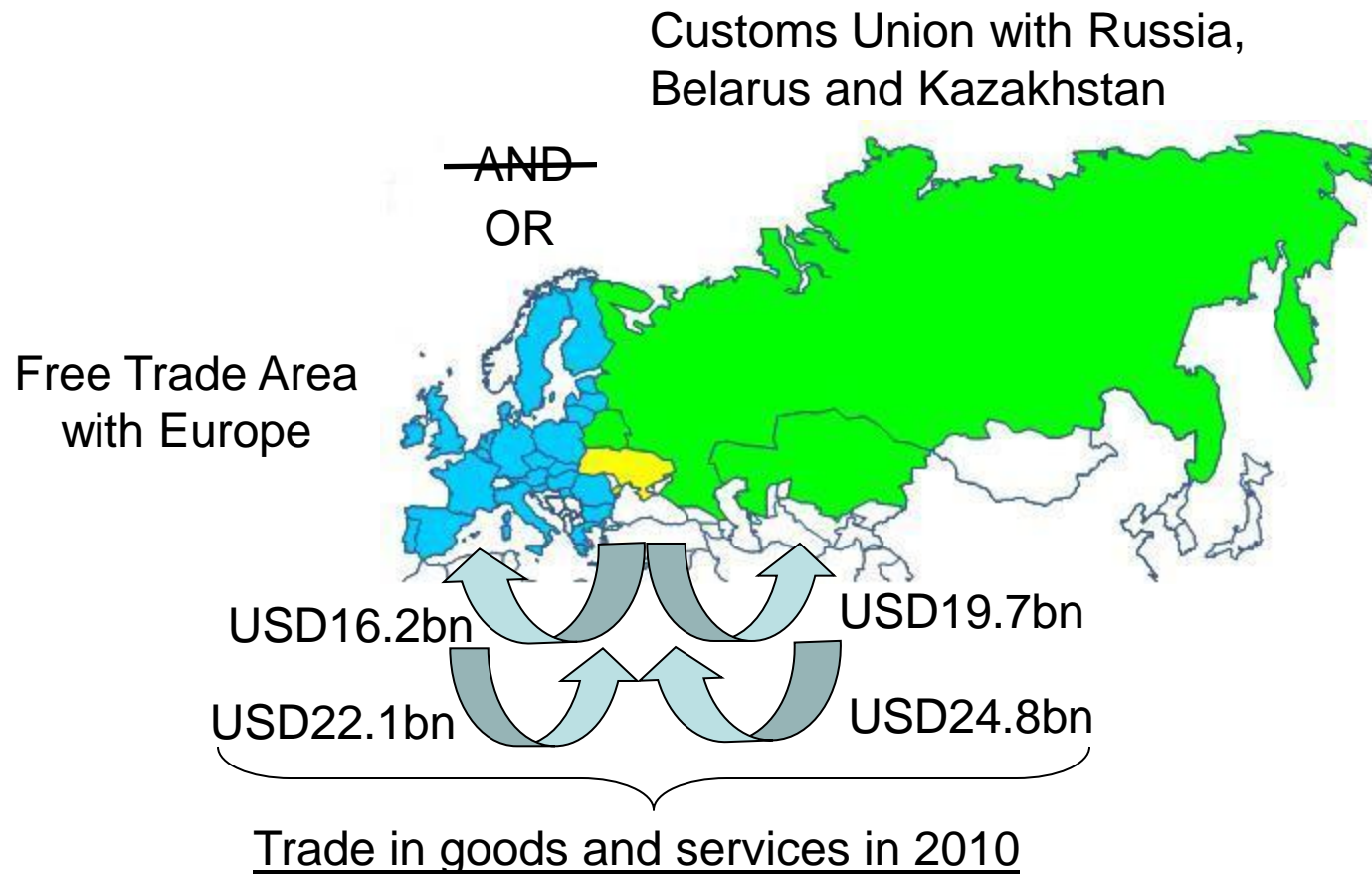
Source: Europe's Energy Portal, State Statistics Service of Ukraine, UkrSibbank's calculations



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Challenge 2: making a “geoeconomical” choice

Ukraine seems to be at the crossroads:



Source: State Statistics Service of Ukraine



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Challenge 3: high social burdens

High pension and benefits ratio in the population's income puts a floor on labor costs. On the positive side, salaries are low in Ukraine providing room for labour-intensive industries.

Chart 1. Breakdown of the (official) population's income in 2010, UAH bn

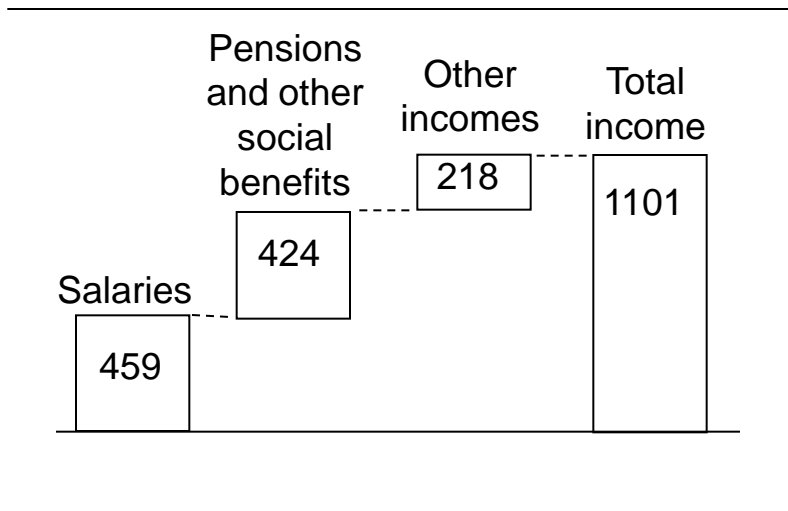
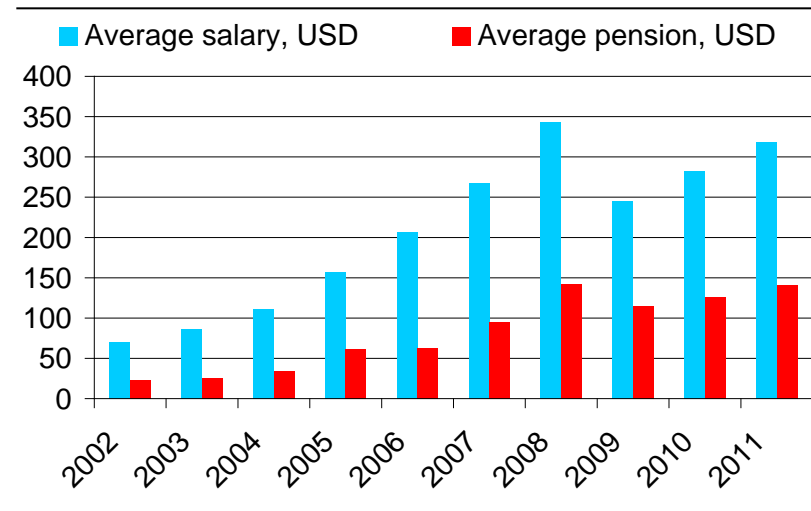


Chart 2. Average salaries and pensions



Source: State Statistics Service of Ukraine



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Challenge 4: competitiveness of Ukrainian economy

Ukraine's major industries face the risk of becoming uncompetitive.



Metals	Higher competition due to overcapacity in China
Machinery	Import substitution in Russia from Russian competitors
Food	Competition from European and Turkish producers



Challenge 5: volatile capital markets

Ukrainian capital markets are small, but they may provide high returns for investors with the right timing for entry and exit.

Chart 1. UX (Ukrainian domestic equities index)

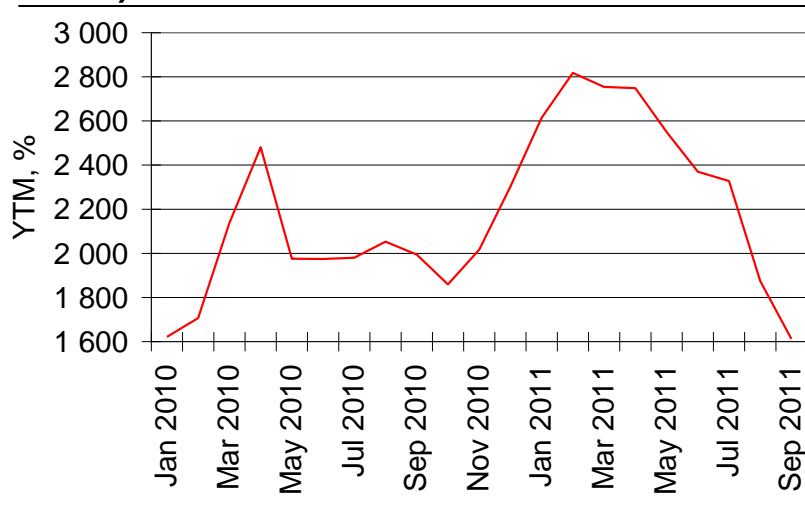
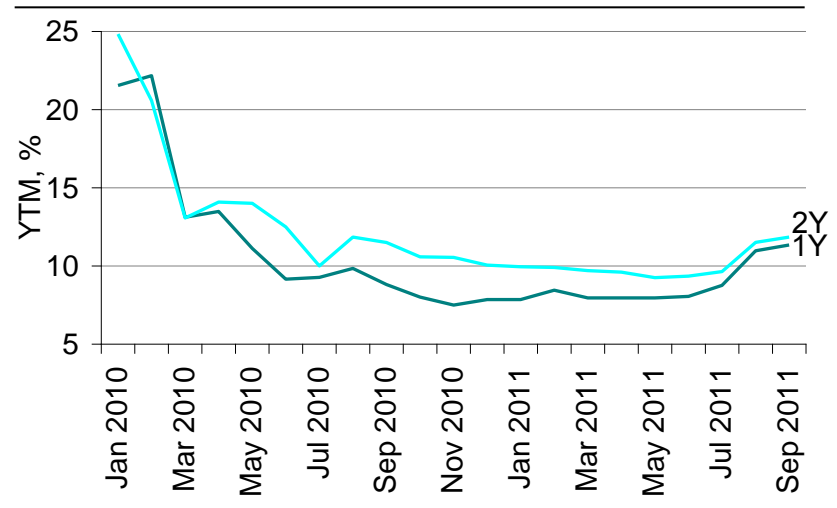


Chart 2. Local sovereign bond yields



Source: Ukrainian Exchange, NBU, MoF



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Major Ukrainian business holdings

Business holdings and their (sole or most publicly known) owners	Metals, ores and pipes	Coal, utilities	Machinery, engineering	Agriculture and food	Oil & Gas	Chemicals	Financials	Transportation	Retail, consumer, media	Real estate, construction
SCM (R. Akhmetov)	●	●	●		●		●	●	●	●
Group DF (D. Firtash)	●				●	●	●		●	●
Privat (I. Kolomoyskiy)	●		●	●	●	●	●	●	●	
Smart Holding (V. Novinskiy)	●		●	●	●		●			
ISD (S. Taruta)	●		●	●					●	
F&C (K. Zhevago)	●		●			●	●		●	
EastOne (V. Pinchuk)	●						●		●	
Ukrprominvest (P. Poroshenko)			●	●					●	
Energy Standard (K. Grigorishin)		●	●							
TAS (S. Tigipko)			●	●			●		●	
Donetskstal (V. Nusenkis)	●	●		●			●			
UIG (V. Antonov)				●			●		●	
State of Ukraine		●	●		●	●	●	●	●	●



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Source: Investgazeta, UkrSibbank

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Growth point 1: agriculture and food (19.3% of exports)

Potential in agriculture is still to be fully unlocked, first of all, through sector consolidation and wider use of modern technologies.

Chart 1. UN Food and Agriculture World Food Price Index

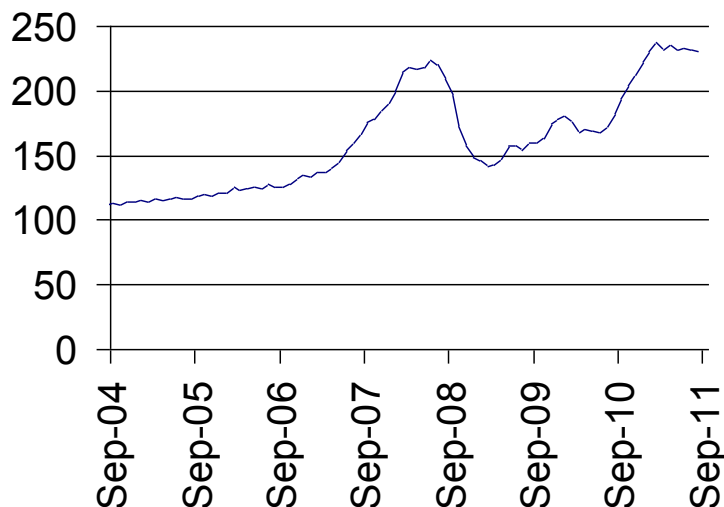
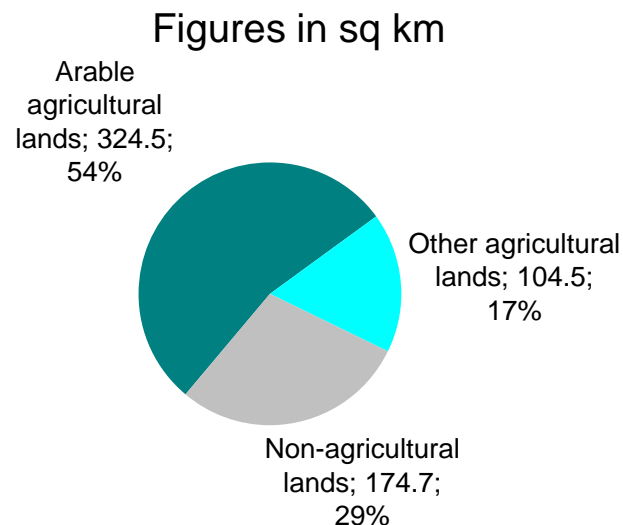


Chart 2. 20 largest agrarian companies own less than 10% of Ukraine's agricultural land



Source: AAA Consulting Agency, Bloomberg



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Growth point 2: machinery (17.9% of exports)

Machinery and engineering is a sector with a high added value. It is being supported by current demand in the former Soviet Union countries.

Chart 1. Exports of machinery

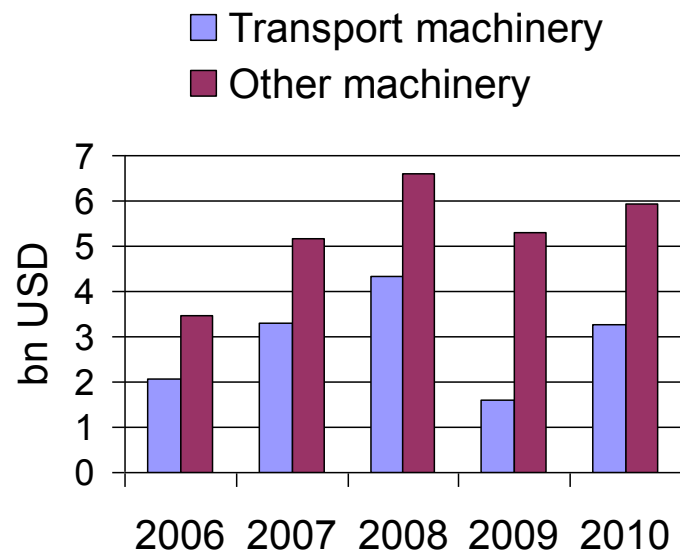
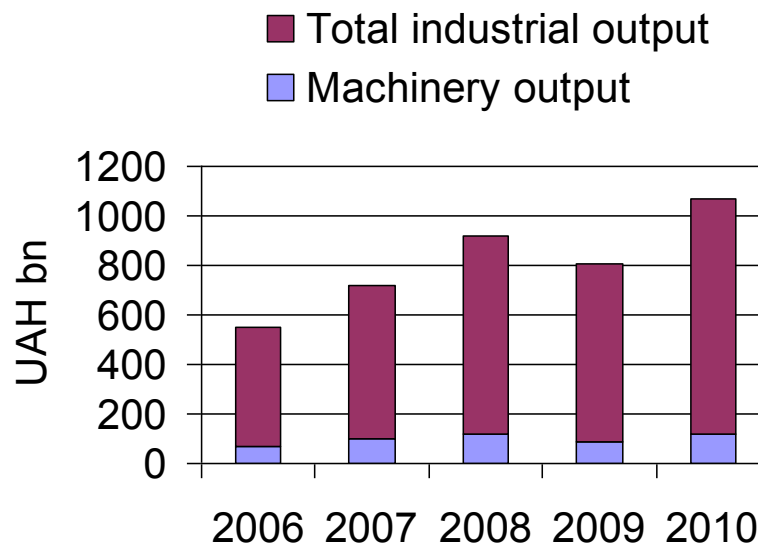


Chart 2. Machinery and total industrial output



Source: State Statistics Service of Ukraine



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Potential growth point 3: modern technologies

Not a growth point for the foreseeable future. The main obstacles are:

- Ukrainian oligarchs are focused on
 - development of the assets they own and
 - still wide opportunities related to privatisation and use of state-owned assets coming from the oligarchs' presence in the power
- not-so-good investment climate for venture capital investments
- limited possibilities for state financing of new technologies, and
- the resulting brain drain

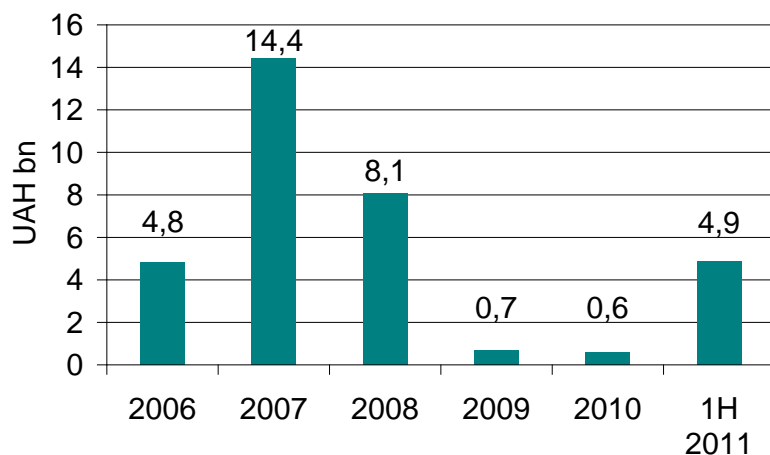


Ukraine's infrastructure largely neglected over the last 20 years requires a complete overhaul.

Local corporate bond market

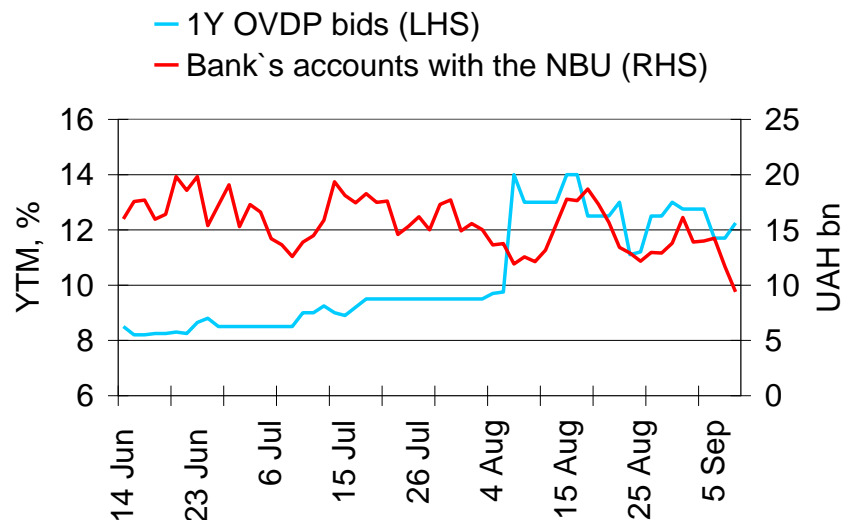
Corporate bonds issuance was (and hopefully will be again) a natural way for Ukrainian companies and banks to get financing.

Chart 1. Local UAH corporate bonds issuance



Note: figures for 2008-2010 include debt restructurings

Chart 2. Recent developments on the local sovereign bond market



Source: cbonds.info, NBU, UkrSibbank's estimates



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Expected developments

The National Bank together with the Ministry of Finance are mulling over introduction of new instruments, including

- USD pegged and inflation linked local bonds
- gold pegged deposits for the population

The government is not going to issue VAT bonds (at least in the near future) as this is not recommended by the IMF.

We think that given the financing needs of Ukrainian corporates and municipalities and more cautious approach of investors to Ukrainian risks (including exchange rate and default risks), a number of special instruments have potential to appear on the Ukrainian market, including

- revenue bonds with escrow features (e.g., airports, potentially toll roads)
- collateralised and convertible bonds
- exchange rate linked bonds

Demand for plain vanilla UAH bonds (both corporate and sovereign) depends on non-resident participation which in turn depends on UAH evolution perspectives.



Thanks for your attention!

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