Ukraine:
Progress towards a Developed Economy

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Main Macroeconomic Indicators

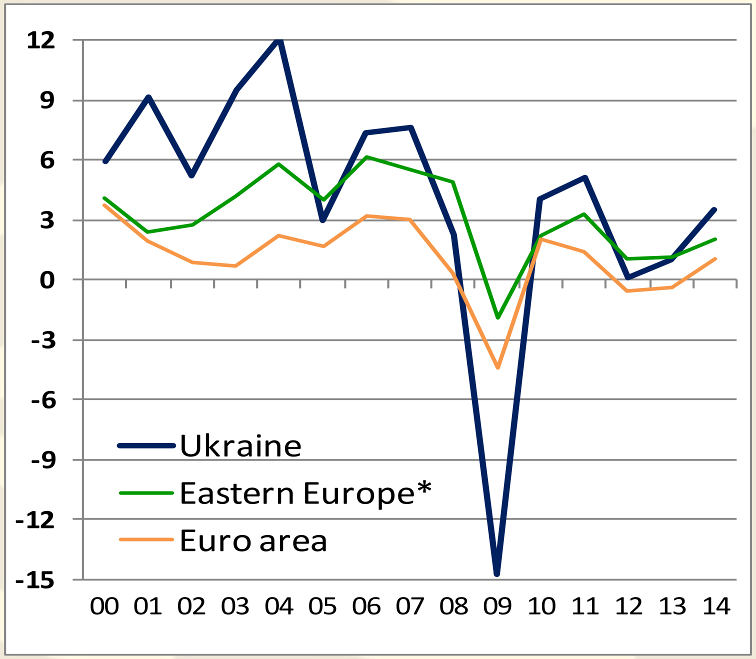
	2000-07 average	2008	2009	2010	2011	2012	2013f	2014f
Real GDP Growth, % yoy	7.5	2.3	-14.8	4.1	5.2	0.2	1.0	3.5
Fiscal Balance, % GDP	-0.8	-2.0	-8.5	-6.7	-4.3	-5.6	-4.0	-3.0
Consumer Inflation, %, eop	11.3	22.3	12.3	9.1	4.6	-0.2	4.0	5.0
UAH/$ Exchange Rate, eop	5.2	7.7	8.0	8.0	8.0	8.0	8-8.4	8-8.5
Current Account, % GDP	2000-05: 5.7; 06-07: -2.6	-7.0	-1.5	-1.9	-5.5	-8.3	-7.0	-6.0
Gross Int. Reserves, $ bn	2000: 1.5; 2007: 32.5	31.5	26.5	34.5	31.8	24.5	25.0	27.0
Foreign Public Debt, % GDP	2003: 21.3; 2007: 8.7	9.2	20.5	23.8	20.4	18.3	18.5	18.5
Foreign Private Debt, % GDP	26.2 47.4	47.1	67.7	62.2	56.8	58.3	56.1	54.1

[*] Includes implicit pension fund deficit (credits from Single Treasury Account (state budget) to cover pension fund expenditures) for 2007-2008 and Pension Fund and Naftogaz imbalances since 2009, excluding bank recapitalization and VAT bonds

Source: NBU, SSC, MinFin, The Bleyzer Foundation

Economic Growth in Select Countries in the Region

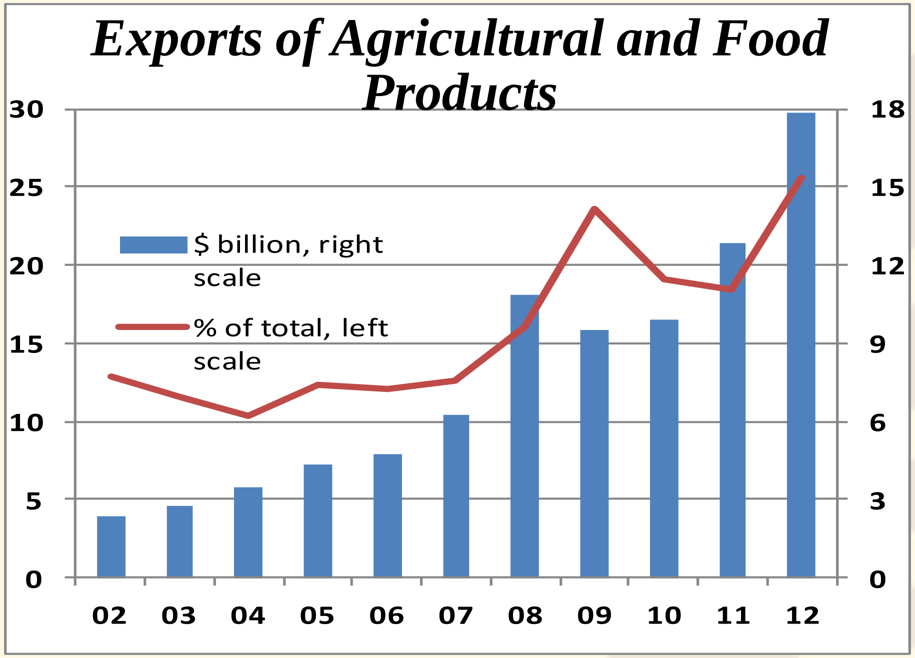
	00-07	08-09	10-11	12	13-14(f)
Euro area	2.2	-2.0	1.7	-0.6	0.4
Hungary	3.6	-3.0	1.4	-1.7	0.6
Poland	4.1	3.4	4.1	2.0	1.8
Romania	5.7	0.4	0.5	0.3	1.8
Ukraine	7.5	-6.3	4.6	0.2	2.3
Russia	7.2	-1.3	4.4	3.4	3.6
Turkey	5.2	-2.1	8.8	2.6	3.6

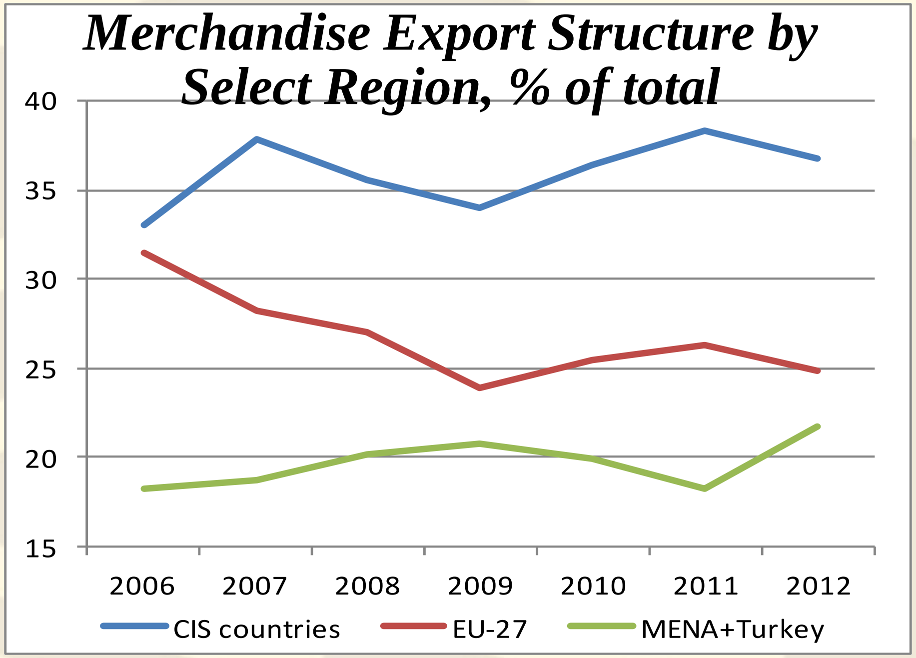


Eastern Europe includes Bulgaria, Hungary, Poland and Romania. The region growth was weighted by the size of the economies.
Source: IMF WEO (April 2013), The Bleyzer Foundation

- The Ukrainian economy grew fast during 2000-2007, was hit hard by the crisis of 2008, but showed strong recovery during 2010-1H 2012.
- In 2H 2012, it was hit by a recession in the EU & global trade slowdown.
- Economic growth is forecast to regain traction gradually from late 2013.
- Beyond 2013, Ukraine's growth prospects still compare relatively favorably with other countries in the region.

Future Sources of Growth: Favorable Export Prospects





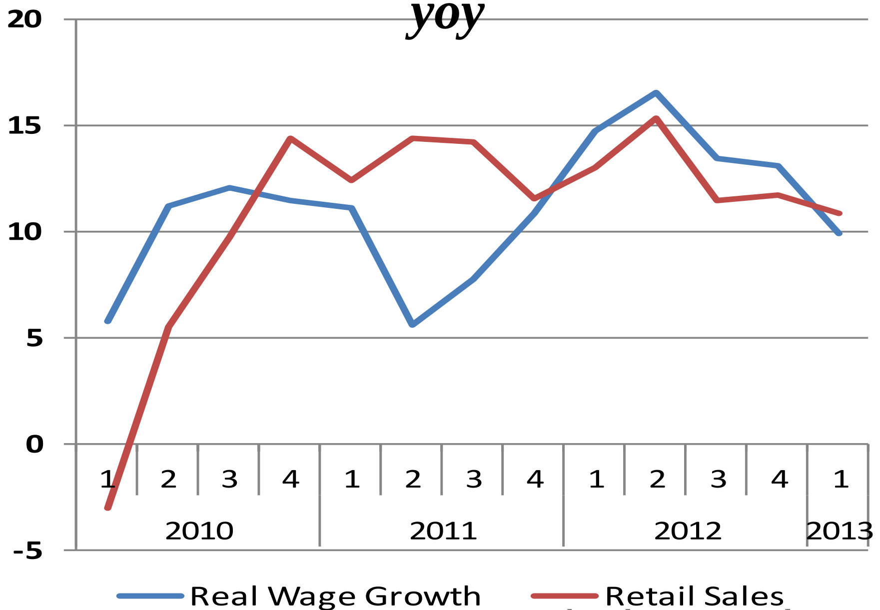
Source: State Statistics Committee, NBU, The Bleyzer Foundation

Ukraine is an open economy, with exports representing 55% of GDP. Despite subdued demand in developed economies, Ukraine's medium-term export outlook is favorable due to:

- geographic diversification with greater reliance on high-growth EMs;
- the uptrend in exports of agricultural commodities;
- prospects of a free trade agreement with the European Union in late 2013.

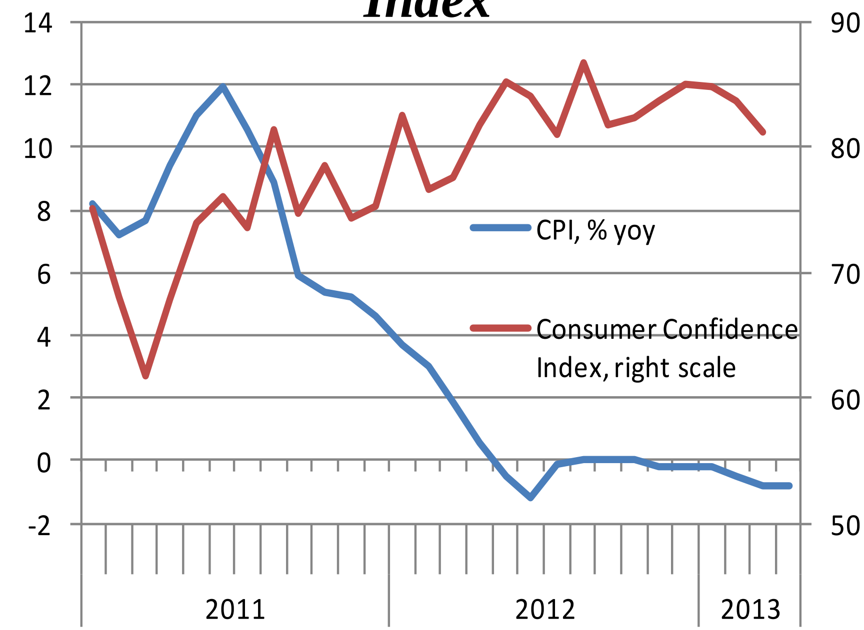
Private Consumption should also drive GDP Growth

Retail Sales and Real Wage Growth, % yoy



Source: State Statistics Committee, NBU, The Bleyzer Foundation

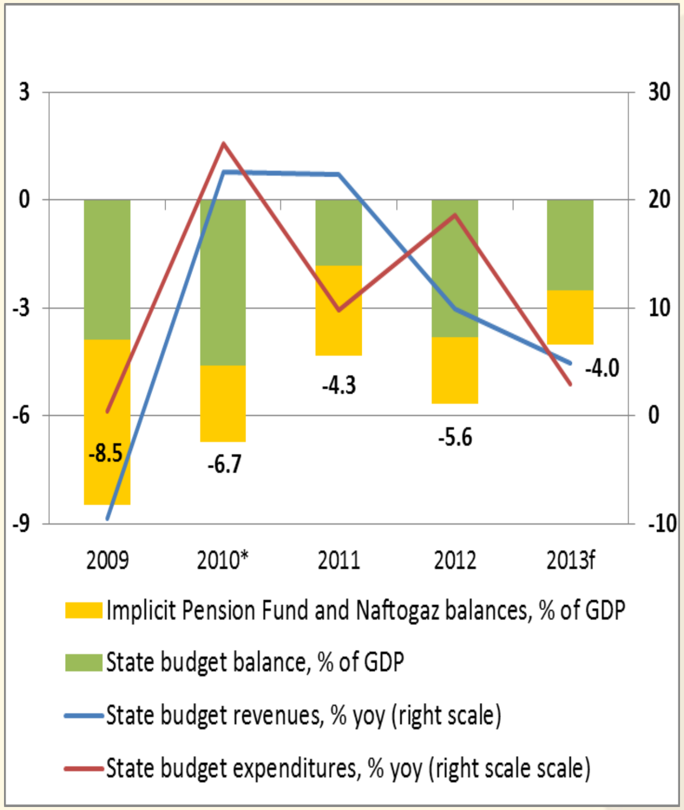
Consumer Inflation and Confidence Index



- Private consumption grew strongly in 2012 on account of low inflation, stable FX rates, robust real wage/pension growth, and consumer confidence.
- Consumption growth may temporary decelerate in 2013, reflecting the need for fiscal consolidation and tight credit, but may speed up in 2014.
- Diminished inflationary pressures, Hryvnia stability and consumer confidence will help sustain consumers' buying power in 2014 and beyond.

Fiscal Policy

Public Finances



- The fiscal deficits are still high about 4% of GDP.
- But we need to recognize that the fiscal deficits have been reduced a lot over the last few years.
- In fact, fiscal budgets deficits have declined from 8.5% of GDP in 2009 to 4.3 % of GDP in 2011, and is expected to be 4% this year and 3% next year.
- Although these numbers are above the IMF proposals, few countries can show better deficit reductions.
- The experiences of Europe, including Italy, Spain, Greece, France show that faster reduction in fiscal deficits can have very negative impacts on GDP growth, more negative than was initially believed.

- Altogether, a relatively good performance for Ukraine, which is reducing the fiscal deficit without creating a recession.
- Rating: 4.5 out of 5.0; Good Progress

Monetary Policies

- Monetary policy has been relatively tight, with money supply increasing by 13% in 2012, compared with growth rates of 40% before the 2008 crisis.
- As a result, inflation was reduced from 22% pa in 2008 to 4.6% in 2011 and -0.2% in 2012 and will be about 4% this year. This is a good achievement.
- Low inflation -- lower than on Ukraine's main trading partners -- meant that there was less currency devaluation pressure from purchasing power parity. In fact, with lower inflation that its trading partners, Ukraine has been gaining in International competitiveness.
- This has provided stability in the exchange rate which has remained at about 8 UAH/$
- Currently, devaluation pressures comes from two sources:
    - First, very expensive gas imports from Russia. Ukraine is paying for Russian gas three times the US spot price for gas, and twice the gas price for Europe. But Ukraine has so far been successful in reducing gas purchases from Russia.
    - The second devaluation pressure comes from very large foreign debt repayments. But here also Ukraine has been successful in raising foreign capital and in rolling over maturing debt.
- As a result, the exchange rate has been quite stable and is expected to remain stable.
- Rating: 4.0 out of 5.0; Good Progress

Deregulation/Privatization

- This is a subjective matter as most conclusions are based on perceptions.
- But the latest World Bank-IFC report on Doing Business 2013 is one of the few attempts to quantify progress on regulation and the business environment. It says that:
  - Ukraine has made progress improving its rating on the Easy of Doing Business from 152 position in 2012 to 132 in 2013, out of 185 countries.
  - The improvement was due principally to simplification of the rules to start a new business, by eliminating minimum capital requirements and eliminating the need for notarized documents.
  - It also reduced the time to register property setting effective time limits for registration.
  - But a ranking of 132 is not good enough. There are major problems in obtaining construction permits, in getting utilities, in protecting investors and property rights, in trading across borders, and in paying taxes.
  - In conclusion, some progress was made but the business environment is still quite bad. Much more needs to be done.
- Rating: 3.5 out of 5.0; Little Progress

Business Transparency

- This is a subject that has remained low, and even regressed.
- The Global Competitiveness Report 2012-2013 of the World Economic Forum concluded that some of the most problematic factors for businesses in Ukraine are related to Business Transparency:
    - Corruption
    - Tax Regulations and Rates
    - Government Bureaucracy
- Some of the lowest ratings were in:
    - Efficiency of the legal Framework
    - Judicial independence
    - Lack of protection of property rights
    - Wasteful government spending and diversion of public funds.
    - Favoritism in government decisions
- Rating: 2.0 out of 5.0; Regress

Moving Forward

- Ukraine may achieve and sustain rates of growth of 4%-5%, and even higher (5%-7%) if it proceeds with investment climate improvements, and addresses the issues presented earlier.
- Ukraine should be attractive for FDI thanks to:
  - A large consumer market with population over 45 million.
  - Very rich agricultural land.
  - A highly educated and inexpensive labor force
  - One of the largest potential amounts of shale gas in Central/Eastern Europe.
  - An open economy that could grow fast with Free Trade Agreements.
  - Reasonable macroeconomic environment.
  - At about 18% of GDP, Ukraine’s external public debt compares favorably with other countries in the region.
  - Although private and public external debt at 75% of GDP is a major burden for Ukraine, it is better than the external debt levels in many EU countries.