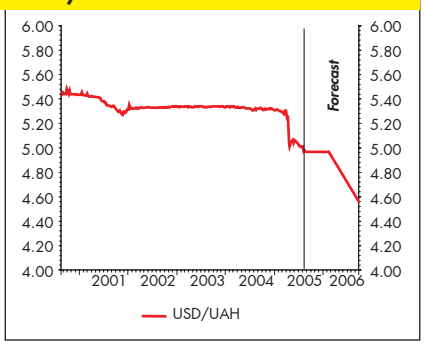
Strategy Ukraine

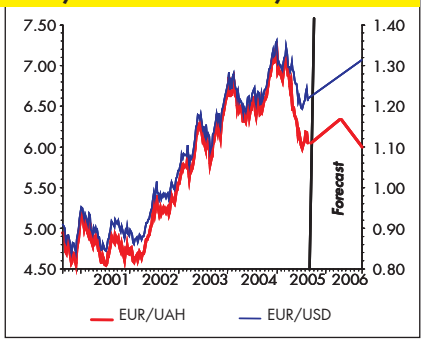
September 2005

USD/UAH outlook



Source: Thomson Financial Datastream

EUR/UAH and EUR/USD



Source: Thomson Financial Datastream

Forecasts

	Dec.05	Mar.06	Sep-06
EUR/UAH	6.03	6.03	6.25
USD/UAH	4.90	4.90	4.70
Discount Rate	9.50	9.50	10.00

Source: Thomson Financial Datastream

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Highlights

- The Ukraine enjoyed strong economy in 2003 and 2004. GDP growth was at a record high of 12.1% in 2004 and grew at an annual rate of only 2.4% yoy in July, compared to 17.2% in July 2004. Especially the trade surplus was reduced due to the deterioration of the "Terms of trade". The incentive to invest was reduced by debates about the re-privatization of some state owned enterprises.

- Inflation has continued to rise in the Ukraine since the beginning of 2001. In July the CPI-Inflation climbed to 14.8% yoy from 14.4% yoy in June. Inflationary pressures should remain high in the following months, because growth is still strong, fiscal policy is very expansive and the Hryvnia appreciated only moderately in trade weighted terms.

- The Hryvnia is probably one of the most undervalued currencies in comparison to other transition economies. The sharp improvement in the "Terms of trade" and the undervaluation were the reason for the improvement in the current account. The inflows from the capital account were also positive and this led to a surge in the foreign currency reserves. We expect that the Ukraine will liberalize the FX-market after the elections in March 2006 and this would prompt another appreciation of the Hryvnia against the Euro and the USD.

- Ukraine´s regulated equity market is small and illiquid. The market capitalization of about 10% of GDP is below that of many other transition economoies. Trading activity has declined in 2003, but it picked up significantly in 2004.

Key economic figures and forecasts

	2002	2003	2004	2005e	2006f
Nominal GDP (EUR bn)	42.4	49.4	64.8	80.5	101.6
Real GDP (% yoy)	5.2	9.4	12.0	5.5	6.5
Industrial output (% yoy)	7.0	15.8	12.5	5.0	7.5
Unemployment rate (avg, %)	3.8	3.6	3.6	3.5	3.2
Real wages, whole economy (% yoy)	20.0	16.7	17.0	15.0	13.5
Producer prices (avg, % yoy)	3.1	7.8	20.4	14.0	18.0
Consumer prices (avg, % yoy)	0.8	5.2	9.0	12.9	10.5
Consumer prices (eop, % yoy)	-0.5	8.0	11.7	11.0	9.0
General budget balance (% of GDP)	0.7	-0.2	-4.1	-3.0	-2.5
Current account balance (% of GDP)	7.5	5.8	11.3	9.5	8.0
Net foreign direct investment (% GDP)	1.8	2.2	1.7	1.5	3.5
Official FX-reserves (EUR bn)	4.2	7.2	9.7	13.5	16.0
EUR/UAH,avg	5.03	6.02	6.60	6.09	6.11
USD/UAH, avg	5.33	5.33	5.31	4.95	4.70
EUR/UAH, year end	5.60	6.70	6.91	6.04	5.98
USD/UAH, year end	5.33	5.33	5.31	4.95	4.60

Source: Raiffeisen RESEARCH

Ukraine
Content

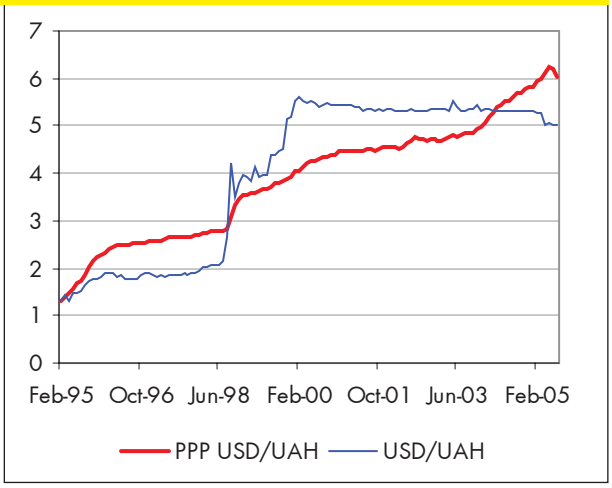
Special focus
Exchange rate

We have developed a model for calculating the fair value of USD/UAH on a "purchasing power parity"-basis (PPP-basis). We used the monthly PPI data from the US and Ukraine to explain USD/UAH movements from 1995 and performed a regression which showed that the model is very significant (p-value: 0.005; R-square: 0.11). According to this model, the fair value in July 2005 would be USD/UAH 6.03. Unfortunately, we have neither monthly nor quarterly data on productivity or unit labour costs. The average rate of productivity growth in Ukraine since 2000 was above 8% (on the whole economy) which was much higher than in the US. If you would also take into account that the "terms of trade" in Ukraine were much better than in the US since 1999 you would get a strongly undervalued hryvnia in our view.

Based on data provided by the IMF and the "National Bank of Ukraine", the hryvnia is also significantly undervalued. First, Ukraine's current account has shown persistently high surpluses in the last few years. In 2004, the country's current account surplus was outstanding compared to other (non-energy-producing) transition economies. Second, wages in Ukraine have remained relatively low (less than half the level of wages in Russia). According to estimates of the IMF (which are based on cross country panel-data models), the equilibrium real exchange rate of Ukraine is less than half that of many other transition economies, which probably reflects a lower capital stock and a lower level of development. However, even considering this lower equilibrium, Ukraine's real effective exchange rate (REER) was undervalued by about two-thirds in 2002. Appreciation since then has been very modest. Given the simple calculation we undertook above, we would be more cautious concerning level of undervaluation, but the development in the current account shows that there is "some" undervaluation. These results do not mean that the hryvnia will appreciate sharply within the coming months, but they show that Ukraine will likely experience sustained upward pressure on its REER over the medium term.

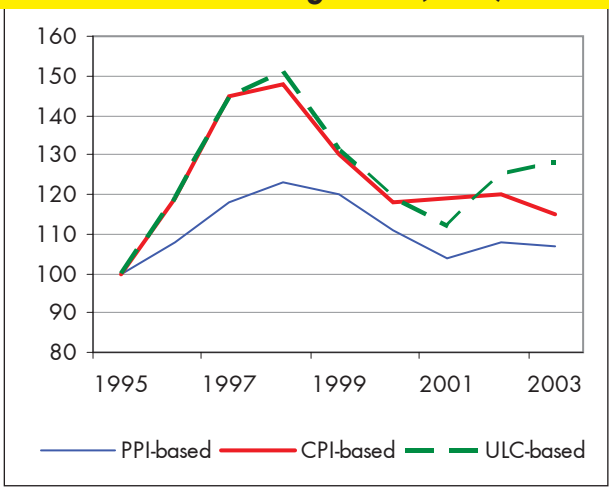
We fully agree with the IMF that surpluses of this size are not desirable over the medium term. Exchange rate misalignment also resulted in a distorted saving-investment balance. Ukraine used a large portion of the economy's export proceeds to finance investment and consumption abroad. The current exchange rate regime has served the

Model for USD/UAH



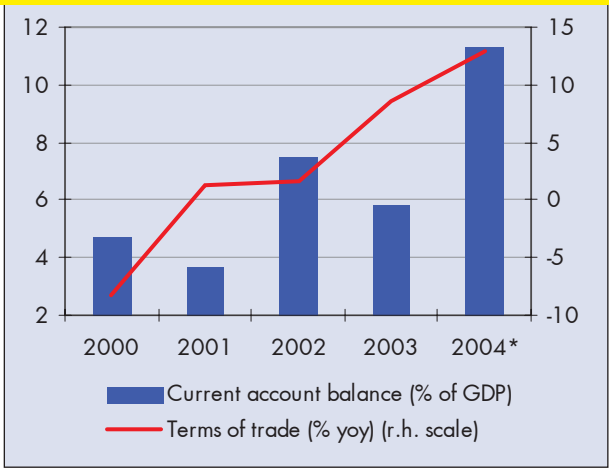
Source: Reuters, Thomson Financial Datastream, Raiffeisen RESEARCH

Real effective exchange rate (REER)*



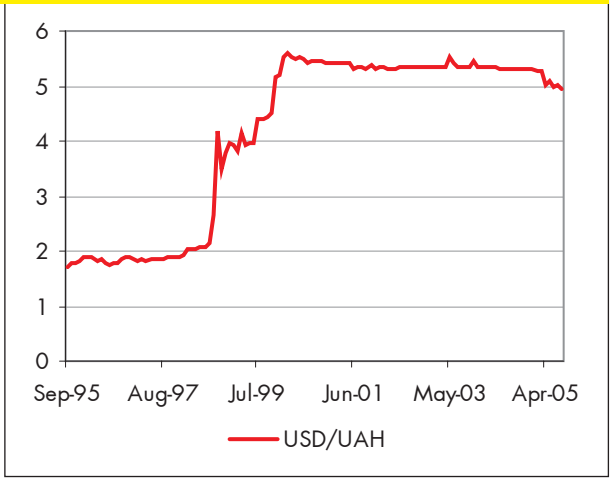
*Note: * 1995 = 100*
Source: IMF

Terms of trade boosting current account



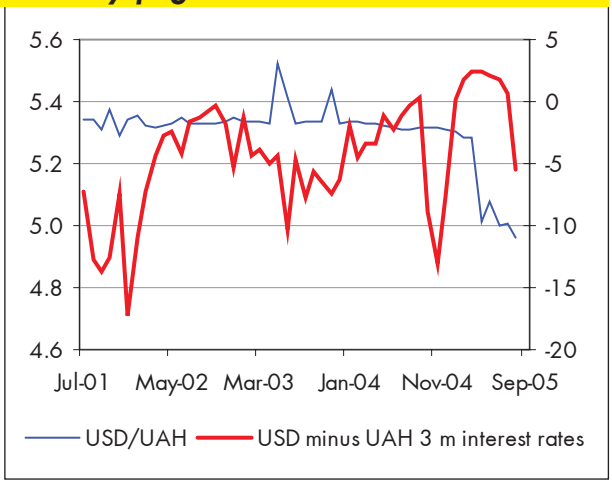
*Note: *The figure for the Terms of Trade 2004 is a projection of the IMF; Source: IMF, Raiffeisen RESEARCH*

Weaker USD ahead



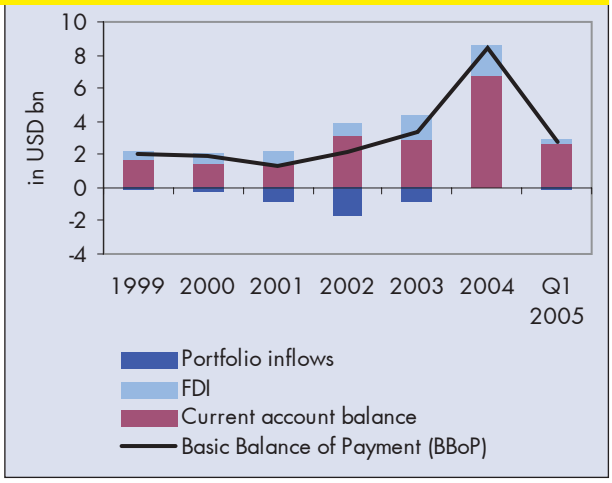
Source: Reuters

Interest rates should be equal to obtain a currency peg



Source: Reuters

Current account and BBoP*



** Basic Balance of Payment = Current account + FDI + Portfolio inflows*
Source: National Bank of Ukraine (NBU)

authorities well in stabilising the economy in the aftermath of the 1998 crisis.

The authorities of the NBU are not convinced that an appreciation of the hryvnia would have positive welfare effects and have only allowed a gradual appreciation of the hryvnia against the USD. On the other side, the trade-weighted Hryvnia did not appreciate and has even depreciated over the last few years. The sharp depreciation of the hryvnia against the euro has been reversed somewhat, because of the correction of EUR/USD. We still expect that the general weakness of the USD is not over, and therefore EUR/UAH may start to rise again without any appreciation of the hryvnia against the USD. The NBU has also argued that greater flexibility on the foreign exchange market would create adverse expectations and instability in the market. The NBU and some politicians in Ukraine are concerned about the negative effects of strong hryvnia appreciation on economic growth. We do not fully share this view, but low investment growth because of uncertainties of the re-privatisation deals could be the reason that the NBU will not change the flexibility of the hryvnia in the coming months.

In the coming months, we do not expect to see appreciation of the hryvnia against the USD to below 4.90. Inflation could fall back slightly in September and the uncertainties because of the elections should not lead to a big step towards 4.80 until March 2006. We also believe that bond yields and interest rates on the money market will rise substantially in the coming year, because of more monetary tightening by the NBU. This tightening could be accompanied by stronger economic growth and an inflation rate which will remain above 10%. Rising interest rates could represent an opportunity for international investors to enter into a more flexible market which would be positive for Ukraine in the long run.

But when will more liberalisation become reality? After the elections and the implementation of a new reform-oriented government there could be more flexibility and an appreciation of the hryvnia against the USD and even against the EUR. Yushchenko and the Economics Minister favour further hryvnia appreciation and FX liberalisation. The president also supports further measures to liberalise the current account and subsequently the capital account as well.

Elections in March 2006

Yuschenko´s party leading the polls

The election of Viktor Yushchenko as new President of Ukraine at the end of last year was a milestone for the country. The new installed government is very pro-Western and investors have turned to Ukraine as the prospects for economic and structural reform improve significantly. In the first few months in office, the new administration has been slow to implement several key policy initiatives it initially had targeted. This was caused by the different opinions of the key policy makers how to proceed. In February 2005, Ukraine and the EU agreed on a 10-point action plan which included strengthening trade relations, achieving market economy status and WTO membership. It could be that Ukraine will join the WTO as early as 2006 and possible negotiations concerning EU membership could start at the beginning of 2007. The government of Ukraine undertook strong efforts to achieve the WTO membership this year, but a package of required legislation was not passed as several bills were blocked by stiff opposition in parliament.

Concerning the political developments in Ukraine all eyes are on the elections in March 2006. A pre-election poll conducted by one of the political think-tanks showed that a Yushchenko/Tymoshenko/Lytvyn electoral alliance could gather 53.4%. That means that they would have a single majority in the new Rada (Ukraine's Parliament). However, the risk is that Yushchenko and Tymoshenko will not cooperate. Yuschenko proved to be more of a liberal market advocate while Tymoschenko prefers a more state-interventionist approach. Tymoshenko has pursued a more populist approach (wage and pension increases) to boost her party´s chances at the elections. Tymoshenko's party is the third strongest party according to the polls behind Yanukovych party "Regions of Ukraine". The FDI result shows that the Tymoshenko's party only has 7.5 percentage of vote. Hence, it is difficult to rely on polls to predict the outcome of the elections.

Our scenario is a majority of the Yushchenko/Tymoshenko/Lytvyn alliance and a continuation of the structural and economic reform steps. A pro-Western government of this composition would be positive for the country in the long run.

Distribution of Rada

Party	Personality	Seats
Our Ukraine	Yushchenko	77
Communist Party	Simonenko	56
Regions of Ukraine	Yanukovych	51
People´s Party	Lytvyn	46
Tymoshenkos´s bloc	Tymoshenko	39
Socialist Party	Moroz	25
Ukrainian People´s Party	Kostenko	24
SDPU	Medvedchuk	20
Unified Ukraine		20
Democratic Ukraine		19
Party of Industrialist & entrepreneurs		15
Democratic Initiatives		4
Independents		37
Unoccupied seats		17
		450 seats

Source: Deutsche Bank

Key political parties, figures, events

Election Schedule		
March 2006	Elections of the parliament (Rada)	
2009	Next presidential election	
Leading figures in Ukraine politics		
Position	**Name**	**Party affiliation**
President	Yushchenko	Our Ukraine
Prime Minister	Tymoshenko	Tymoshenko´s bloc
First Vice Prime Minister	Kinakh	Party of Industrialist & entrepreneurs
Minister of Economy	Terjokhin	Our Ukraine
Minister of Industry	Shandra	Our Ukraine
Minister of Labor and Social Policy	Kyrylenko	People´s Party
Minister of Energy	Plachkov	
Minister of Finance	Pynzenyk	
Governor of the National Bank of Ukraine (NBU)		

Source: http://www.kmu.gov.ua/control/

July 2005 poll results

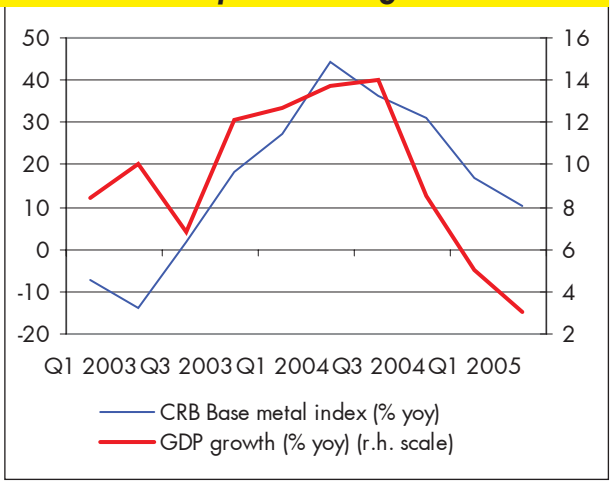
Party	KIIS*	FDI*
Our Ukraine	35.6	34.0
Tymosheko´s Bloc	14.1	7.5
Regions of Ukraine	17.8	18.5
Communist Party	8.5	6.5
Socialist Party	5	4.0

**Political think-thank*
Source: Deutsche Bank

Growth driven by consumption

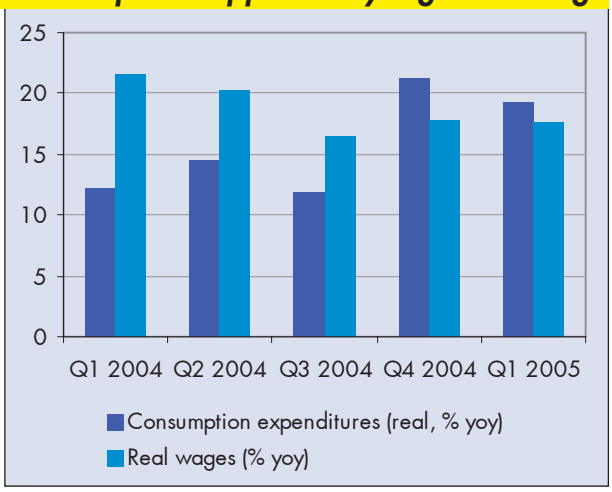
Export and investment weaker in 2005

Base metals important for growth



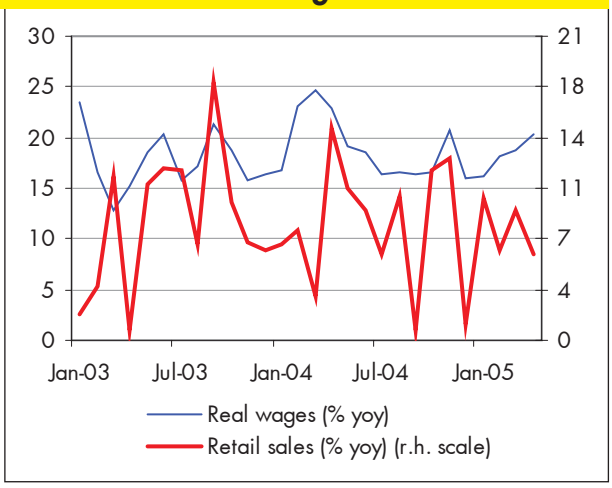
Source: Statistics of the Ukraine; Datastream Thomson Financial

Consumption supported by high real wages



Source: Statistics of the Ukraine

Inflation should be negative for retail sales



Source: Thomson Financial Datastream

Ukraine's GDP grew at an annual rate of only 2.4% yoy in July, compared to 17.2% in July 2004. This growth rate was the slowest for five years, and significantly below the government forecast of 8.2% for 2005. The country enjoyed strong growth in 2003 and 2004, with GDP growth posting a record high of 12.1% in 2004. Industrial output grew by a whopping 18.8% yoy in 2004. In particular, the two leading industrial branches - machine-building and metals - were the main profiteurs of the export boom. Both sectors recorded a dramatic slowdown during the first half of 2005 mainly due to the industrial slowdown in the world economy. The growth of base metal prices has also slowed down sharply this year. Ukraine mainly exports ferrous and non-ferrous metals. The chart shows that Ukraine economy is strongly dependent on the development of metal prices. In particular, the trade surplus was reduced due to the deterioration of the "terms of trade". As mentioned, the metal sector is very export-oriented and therefore one can see the effects of the "terms of trade" immediately. Metal prices were generally boosted by the strong demand from China and the recent downturn should rather be a correction. The upswing in demand from Asia (China, India) is structural and not cyclical and that should be positive for the export-oriented sectors in Ukraine. Investment also declined sharply after the blockbuster growth rate of 28.0% yoy in 2004. The incentive to invest was reduced by debates about the re-privatisation of some state owned enterprises. The government added to investors worries by a series of contradicting statements regarding the scope and the particulars of the upcoming re-privatisation scheme. GDP growth in 2004 was supported by private consumption which rose by 15.1% yoy. This booming consumption is backed by a strong rise in households' disposable income. The latter jumped by 24.8% yoy in real terms in the first four months of 2005. The strong rise in disposable income was induced by a strong pick-up in government transfers. Increased social spending is partly a legacy of the previous government, which doubled the minimum pension in September 2004, but it is also due to the 2005 budget amendments enacted by the new government in March. The minimum pension was increased by another 17% from 1 January. The average pension increased by even more, by nearly 22%. This generous fiscal policy will probably hold until elections are held in March 2006. The unemployment rate fell sharply from 2000 until July 2005. The falling unemployment rate was also a positive factor for consumption.

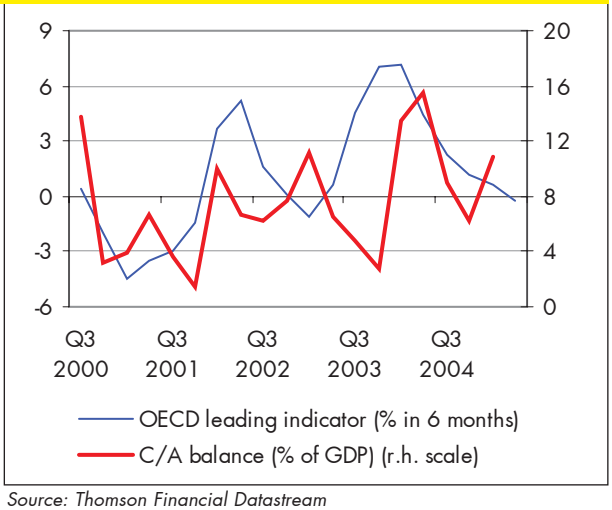
Strenght of the current account
dependent on "Terms of Trade"

Ukraine has a very export-oriented economy. The export/GDP ratio was above 50 percent in 2004. The worsening of the "terms of trade" immediately led to a deterioration in the trade balance. As the chart shows the "terms of trade" were influenced by a weaker industrial cycle in the world economy. The OECD leading indicator shows that activity in the world is a good leading indicator for Ukraine's current account. The change of the OECD leading indicator on a 6-month horizon shows a high correlation with the change in the CRB commodity index over the same period. Export growth particularly in Ukraine's main export - ferrous metals - already began to slow down in the period January to May (exports grew just 10.4% yoy in this period, down from over 50% in the same period last year). The trade balance for the first half of 2005 showed a surplus of only USD 1.9 bn in comparison to USD 6.9 bn for 2004. We expect that metal prices will climb again, because the "China story" has not ended yet. A revival in the world industry as we saw since June has the potential to jumpstart exports in Ukraine again. Our view is that the trade balance will once again have a positive effect on growth in the next few months. We estimate a current account surplus of above 9% of GDP this year. One risk factor would be a further spike of the oil price, because oil imports in Ukraine will be boosted by strong consumption and investment. Current transfers remain supportive for the current account.

From the export structure in Ukraine it is interesting that Europe (including CEE) is the country's most important trading partner. Asia and especially Russia are also very important trading partners. China's importance could grow because the commodity boom in China will lead to high demand for metals. So the USD indirectly remains the most important currency for Ukraine as Asia, Russia and the US has a share of about 50% of total exports to Ukraine. Most of the Asian currencies are still pegged to the USD, although there could be a change in this regard in the coming years.

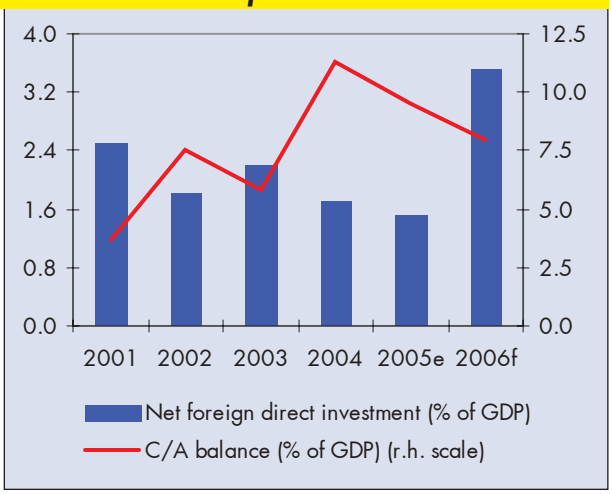
Foreign direct investment (FDI) in Ukraine rose by USD 491 mn in the first half of the year. This was less than the USD 573 mn increase in the same period of 2004. We expect FDI inflows to strengthen after the elections in March 2006 at the latest. The uncertainties concerning the investment environment surrounding privatisations should disappear after the elections.

World economy important for exports



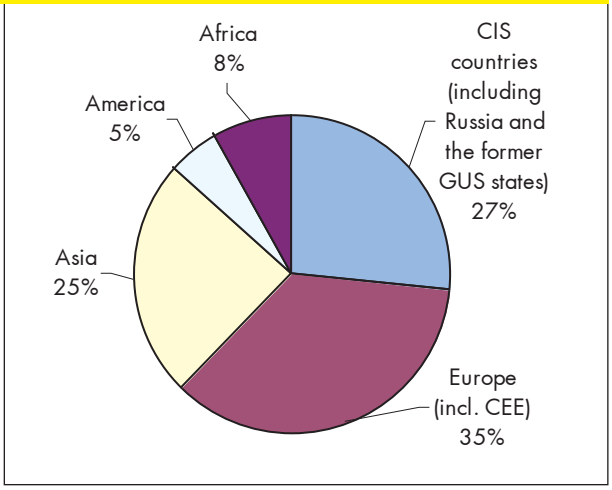
Source: Thomson Financial Datastream

FDI's weaker on privatization concerns



Source: WIIW

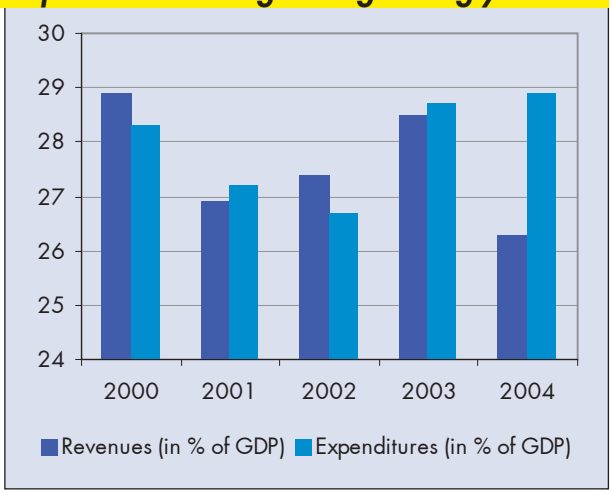
Exports to Europe (incl. CEE) are high



Source: Statistic Committee of the Ukraine

Fiscal policy very expansive
tightening after the elections

Expenditures are growing strongly



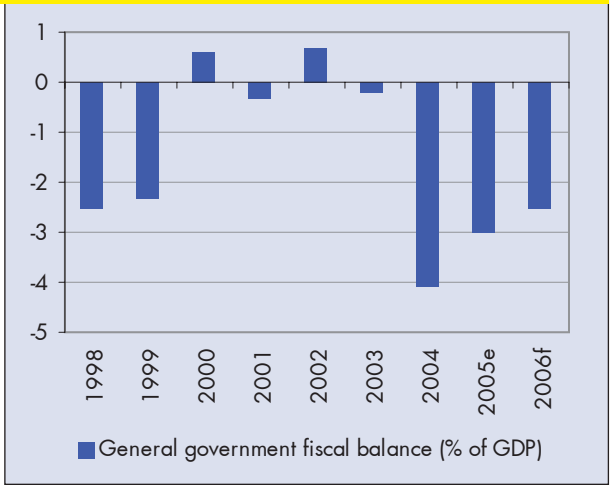
Source: State Statistic Committee of Ukraine; WIIW

Public finance

	2000	2001	2002	2003	2004 Proj.	2005 Proj.
Consolidated government budget balance, cash basis*	-1.3	-1.6	0.5	-0.7	-4.6	-1.8
Primary balance*	1.8	0.4	1.8	0.3	-3.6	-0.9
Public debt*	47	38.6	35.7	30.3	26.9	21.8
External public debt*	33.1	26.6	24	21.9	19	15.1
Debt service (in % of exports of goods and services)*	10.4	8.7	5.7	6.3	4.8	5.2

** in % of GDP*
Source: IMF

Bugdet deficit was growing in 2004



Source: CSFB, Raiffeisen RESEARCH

Monthly revenues exceeded the government's expectations for the 2005 budget, despite the weaker-than-expected growth figures in the first half of the year. In Jan-Jul, revenues were 6.9% ahead of plan. The Ministry attributed this overperformance to the successful crackdown on corruption in customs and the vast increase in customs duties paid in the year-to-date. Budget performance so far this year is consistent with a general government deficit of 2.5% of GDP, well below the 4.5% deficit registered in 2004. A tool to combat inflation will be tighter fiscal policy in the future, but before the elections in March 2006 the probability of a more restrictive policy is low, especially if the polls start to show a decline in support for the Prime Minister. As a result, we expect a 3% deficit (about UAH 12 bn) for the general balance. According to the government's plan, the deficit of UAH 7 bn (forecast of the Finance Ministry) would be covered through privatisations, with domestic debt issuance offsetting net repayments on external debt. On the privatisation front, it seems that the target of revenues of UAH 7 bn is not feasible for this year. For example, the privatisation of Ukrtelekom has been shifted to after the elections. The head of the property fund, who is a Socialist, said that he does not believe that this deal will be successful. There is also a risk that the privatisation of the Kryvorozhstal steel mill in October will be delayed, as the previous owner is expected to continue appealing the decision to reverse the sale. A delay until next year will increase the deficit by 1.2-2 bn UAH (according to estimation of the selling price). After the elections, the government will have to make steps to tighten fiscal stance in 2006. This would leave little room for new spending initiatives or tax cuts, and require that wage and pensions increases be strictly limited or even reversed.

According to the Finance Ministry's rough estimates, the revenue side of the 2006 budget will account for up to 30% of GDP. This year revenues should be approximately 26.3% of GDP. The draft government programme for Ukraine's economic and social development projects real GDP growth of 9.5% in 2006 in comparison to 8.2% for 2005. We would not fully rule out that the Ukraine will reach that levels this and next year, but the risks to that forecast are to the downside. There will probably be some tightening on the expenditure side next year, but the projections of the Finance Ministry point to lower revenues than they forecast. That means that the budget deficit in 2006 should decline only slightly.

Inflationary pressures are rising

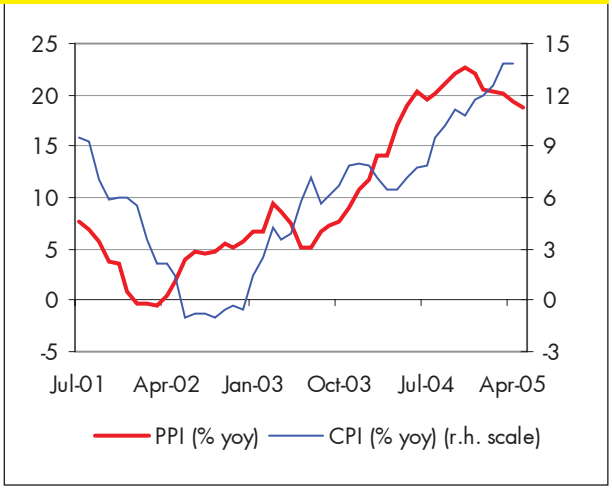
wage growth not sustainable

Inflation has continued to rise in Ukraine since the beginning of 2001. In July, CPI inflation climbed to 14.8% yoy from 14.4% yoy in June. Inflationary pressures should remain high in the coming months, because growth is still strong, fiscal policy is very expansive and the hryvnia appreciated only moderately in trade-weighted terms. However, the PPI fell to 14.8% in July from 25 % in November 2004, which should benefit the CPI. The CPI should ease back in August as a result of seasonal food price declines. Inflation was mainly driven by food and energy prices, but price inflation in services was also nearly 8% in 2004.

As the chart illustrates there is a strong correlation between M3 growth and nominal GDP growth. Similar to M3 growth, real GDP growth fell back, but the monetary overhang still remains intact. This overhang of M3 growth adds to inflationary pressure. The expansive policy is also reflected in the excessive rise in foreign currency reserves, which were still near a record high in July. As long as the National Bank of Ukraine (NBU) intervenes on the FX market there will be no sustainable backdrop in the money supply.

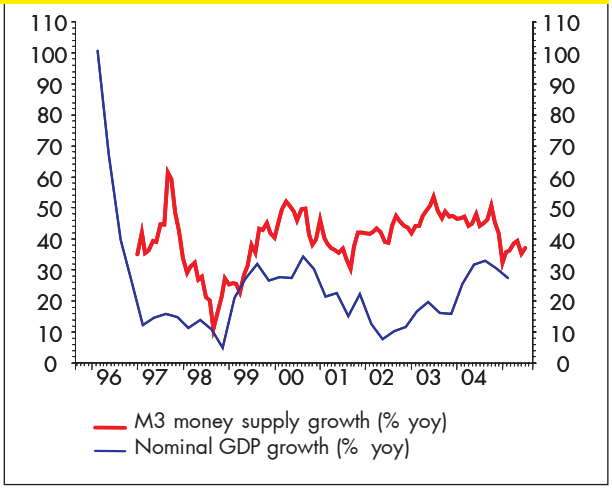
Another factor which is relevant for the growing inflationary pressures (especially in the service sector) is high wage growth in Ukraine. Real wages growth has been above 15% in every year since 2000. Productivity has grown much slower than real wages since 2001. If nominal wage growth exceeds productivity by as much as in Ukraine, it will only be a question of time until inflationary pressures mount. According to our estimation the NAIRU lies at 3.6%. Unempolyment undershot this target for many months and the tightening labour market is therefore fuelling inflationary pressures. The competitiveness of Ukraine's export-oriented enterprises remained strong, despite high real wage growth as the hryvnia depreciated sharply against the euro (since 2001) and held stable against the USD and the Russian rouble. Wage growth in Russia has also been very high and the average nominal wage in Ukraine remained below that in Russia. We believe that an appreciation is the most effective tool to curb inflation over the long run. The NBU currently estimates the pass-through from FX to inflation to be 0.2-0.3 percentage points for each percentage point of appreciation over 12 months. Our guess is that inflation will fall back until October and after that it will reaccelerate again, spurred by stronger growth.

PPI pressures are falling



Source: Thomson Financial Datastream

Money supply is exceeding nominal GDP



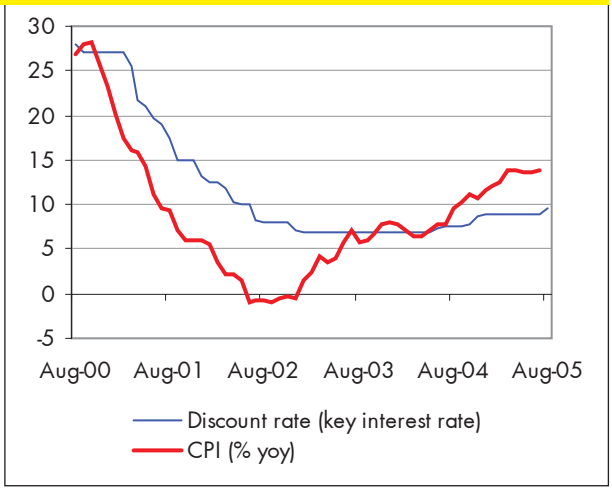
Source: Thomson Financial Datastream

Real wages much higher than productivity

Source: WIIW

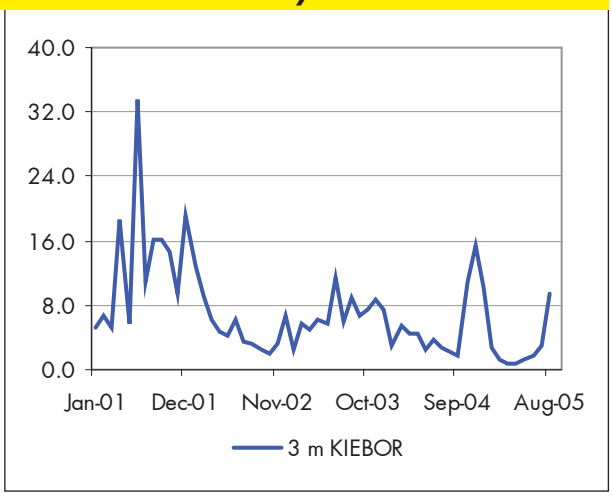
Monetary policy too expansive
tightening ahead

Discount rate below CPI



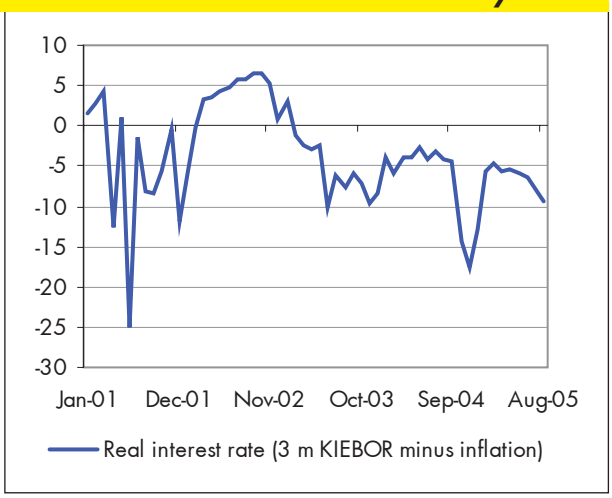
Source: Thomson Financial Datastream

3 month KIEBOR very volatile



Source: Reuters

Real interest rate are unsustainably low



Source: Reuters

The National Bank of Ukraine (NBU) tells us the following about monetary policy:
"The National Bank shall pursue the discount monetary policy and the currency exchange policy and apply currency restrictions, if necessary. The National Bank shall pursue the discount monetary policy by altering the discount rate of the National Bank to regulate the flow of capital and to balance the payment liabilities, as well as to adjust the exchange rate of Ukraine's monetary unit to the foreign currencies. The National Bank shall pursue the currency exchange policy on the basis of the regulation of the exchange rate of Ukraine's monetary unit to the foreign currencies by means of the purchase and sale of the foreign currency on financial markets."
The discount rate is currently at 9.5% and was increased by the NBU this month. The interbank market in Ukraine is flooded with liquidity, and therefore interest rates are much lower than the discount rate. The NBU is now trying to tighten liquidity after the inflation figure for July was far above expectations. Normally, inflation falls in July and August because of lower food prices (due to seasonal factors), but that was not the case this year. After the release of the inflation figure for July, volatility on the money market (interbank market) rose. The overnight rate went up by nearly 6% within one week. The Bid-Ask-Spreads on the money market in Ukraine are sometimes 3-10% which shows that the market is not really working. The NBU has no possibility to influence the money market via the discount rate, which is more used for budgeting purposes and determining overdue tax penalties. The banking sector has only one possibility to get rid of the excess liquidity and that is by "Certificates of Deposit" (CDs). CDs are a tool for the NBU to control liquidity and the money supply. The central bank is acting as a currency clearing house and it uses regular intervention to defend the exchange rate target. The problem therefore is that the NBU has a currency target and an inflation target, which is difficult to reach when the currency seems to be massively undervalued. The current account surplus was rising rapidly last year and capital inflows also surged, because of speculation about hryvnia appreciation. In the long run, it will not be possible for the NBU to achieve a currency and an inflation target. Interest rates on the money market will have to rise to bring inflation down. We expect that the real interest rate will not be able to stay as low as it is at the moment. We think that the currency would be one tool to combat inflation.

Ukraine bond market
interesting for investors in the long view

While financial intermediation through the banking system has grown rapidly over the past four years, capital markets remain small and illiquid. The stock of domestic government securities is low and secondary markets are thin. A lack of appetite and high risk premiums for government securities constituted a financing constraint for the government. After gaining an access to international capital markets the government issued USD 2.1 billion Eurobonds in 2003 and 2004. The government has restorted predominantly to external financing.

The domestic government securities are mainly held by the NBU. Only 1,5% of GDP was held outside the NBU at end 2003, which was the bottom end in international comparison. That means the stock of tradable government securities is very low. The vast majority (more than 90%) of tradable government securities is held by commercial banks. In 2004 however, international investors come into the Ukraine market for the first time since the financial crisis in 1998. The last auction brought a yield of 6.30% for a one year government bond (in UAH) and a five year bond had a yield of 8,0%. After the political crisis at the beginning of this year in the Ukraine at the beginning of the year, yields on the local bond markets fell sharply and reached nearly 6% for 5 year maturities.

Ukraine Eurobond market exhibited significantly positive performance with spreads on all issuers contracting by about 50-100 basis points during this year. Major rating agencies lifted Ukraine rating in the light of political situation bettering and persisting sound fundamentals. Whilst the government still must define and implement a coherent economic and social agenda any further progress will depend on the government ability to deliver tangible results. In this light further improvement in Ukraine rating will go hand in hand with reform implementation. We believe Ukraine sovereign Eurobonds issued by central government might be adequately priced and at present they contain a limited upside possibility for investors. At the same time we are more upbeat about Ukraine bonds issued by government owned entities which credit wise retain a quasi-sovereign status. For conservative buying we recommend City of Kiev (Ukraine capital) and Naftogaz (a major state owned energy company) bonds, both issuers originate from government sector. While from corporate issuers we suggest picking bonds of Kyivstar, which is the largest cell telephony operator in Ukraine with majority stake belonging to Norway's Telenor.

Investors in government securities 2001-2003 (in % of total stock)

	2001	2002	2003
Commercial banks	10.7	20	22.6
NBU	83.1	78.5	67.5
Institutional investors	0	0	0
Other investors	6.1	1.4	10.7
Nonresidents	0	0	0.6

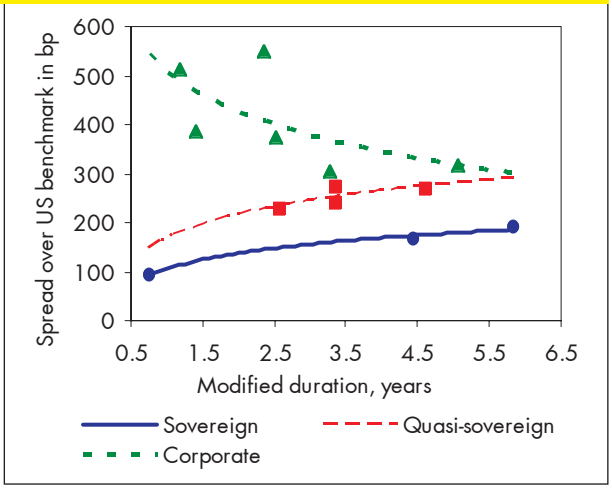
Sources: National Bank of Ukraine; IMF

Ukrainian capital market, USD mn

	2000	2001	2002	2003	2004
Total cap.market turnover	7,210	12,747	20,390	38,060	60,398
Trading on PFTS					
Primary Market					
Options		2.0	12.8	18.3	2.9
Corporate bonds	0.5	2.3	7.7	1.4	0.5
Shares (cumulative)	19.1	26.5	9.0	6.2	2.5
- Shares (SPF* Auction)	7.3	18.5	1.3	2.5	2.5
- Shares	11.8	8.0	7.7	3.7	0.0
Secondary Market					
Corporate bonds	0.1	20.8	140.8	380.8	814.9
Government Bonds	0.0	909.3	889.2	97.7	122.5
Shares	240.8	185.8	118.0	96.3	201.2
Municipal bonds	0.0	0.0	0.0	2.5	166.7
Other	8.4	23.3	0.2	0.0	4.9
All securities					
Total volume of trades	269	1,170	1,178	603	1,316
Average Daily Volume	1.1	4.8	4.8	2.5	5.3

**SPF - State Property Fund of Ukraine, SPF auction - part of privatization process in Ukraine.*
Source: State Statistics Committee, National Bank of Ukraine, Ministry of Finance, SSMSC, PFTS, RIU Research, Reuters

Eurobonds: A spread curve by segment



Note: yield curve is approximated from particular dot points corresponding to exact level of bond spreads; sovereign includes only central government; quasi-sovereign includes municipalities and government agencies/companies; corporate includes privately held companies and banks
Source: Reuters; Raiffeisen RESEARCH

Economic growth is pushing Ukraine equities

Major privatisation and M&A deals, 2004

Sector	Transactions	Total* , USD mn.
Chemicals	4	113.3
Banking	4	205.5
Insurance	3	42.0
Metallurgy	17	2 705.2
Other	28	192.3
Total	56	3 258.3

**Total proceeds, including investment commitments*
Source: State Statistics Committee, National Bank of Ukraine, Ministry of Finance, SSMSC, PFTS, RIU Research, Reuters

Market capitalisation of 5 biggest companies

Company	Capitalisation, USD mln. Sept.2005	Share, %
Ukrtelekom	2 799,67	12.92
Azovstal	2 262,80	10.44
Mariupol Metallurgical Plant	2 223,41	10.26
Ukrnafta	2 067,13	9.54
Zaporizhstal	1 047,50	4.83
Total capitalisation (PFTS version)	21 671,62	100

Sources: State Statistics Committee, National Bank of Ukraine, Ministry of Finance, SSMSC, PFTS, RIU Researc, Reuters

Ukraine equity market: Steeply rising

Source: Reuters

Ukraine´s regulated equity market is small and illiquid. The market capitalization of about 10% of GDP is below that of many other transition economoies. Trading activity has declined in 2003, but it picked up significantly in 2004. The most trading takes place outside the regulated markets (an estimated 90-95% according to the SCSSM). The turnover on the market was about USD 180 million per month in 2004. This compares to a monthly turnover of about USD 500 million in the Czech Republic, Hungary and Poland in 2002. The underdevelopment of the Ukraine market reflects the slow progress in privatization, weakness in corporate governance, delays in passing the Joint Stock Company Law, and the particular ownership structure of corporates in which owners are unwilling to give up control and subject themselves to public accountability. Market concentration is still too high in the Ukraine. The biggest enterprise - Urktelecom, which is still majority state owned - accounts for almost one third of the whole market capitalization. The biggest five enterprises make up nearly 60% of capitalization. The majority of the approximately 300 companies are not actively traded. Of the large number of banks and insurance companies in Ukraine, only 13 are listed on the stock exchange PFTS with a mere market capitalization of USD 40 million.

The PFTS index rallied to a new all time high in August 2005 and the performance in comparison to last year (August 2004) was above 100%. Positive impulses have come from Russia - indirectly through strong Russian capital markets and directly through increased interest by Russian investors. Western investment funds have also started to place orders.

Nevertheless, the development of the PFTS index needs to be interpreted with caution. Due to the size and lack of liquidity of the market, few transactions can have significant impact on stock prices. Moreover the biggest four companies of the market account for more than 40% of market capitalization. From a macroeconomic perspective high inflation is a risk for the Ukraine equity market; the expansive fiscal policy will have to be corrected after the elections otherwise investors could be more cautious because of inflation. In the long run a sharp appreciation of the Hryvnia is negative for Ukraine equities. On the other side more flexible capital markets should attract more foreign investors (Source: Ukraine Report IMF).

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Cut-off for data: 26 August 2005
This report was completed on 6 September 2005

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Published by: Raiffeisen RESEARCH GmbH, Peter Brezinschek, 1030 Vienna, Am Stadtpark 9.

Published and manufactured in Vienna.

Abbreviations

Currencies and countries

BAM	Bosnian marka
BGL	Bulgarian lev
CSD	Serbian dinar
CZK	Czech koruna
EKK	Estonian kroon
HRK	Croatian kuna
HUF	Hungarian forint
LVL	Latvian lats
LTL	Lithuanian litas
PLN	Polish zloty
RON	Romanian lei
RUB	Russian rouble
SIT	Slovenian tolar
SKK	Slovak koruna
TRL	Turkish lira
UAH	Ukrainian hryvnia

Economic abbreviations

avg	average
yoy	year on year
LCY	Local currency
GDP	Gross Domestic Product
C/A	Current account
T/B	Trade balance
FDI	Foreign direct investments
CPI	Consumer price index
PPI	Producer price index
FX	Foreign exchange
ULC	Unit labour costs
%-chg	Percentage change (not in percentage points)

Stock exchange indices

BET	Romanian stock index
BUX	Hungarian stock index
PX 50	Czech stock index
RTSI	Russian stock index
WIG 20	Polish stock index

Equity related

DY	Dividend yield
EG	Earnings growth
LTG	Long term (earnings) growth
P/E	Price earnings ratio

CEEC-4	Central and Eastern European Countries - 4 Czech Republic, Hungary, Poland, Slovakia
CEEC-8	CEEC-4 + Estonia, Latvia, Lithuania, Slovenia
SEEC-6	South East European Countries - 6 Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Romania, Serbia and Montenegro

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