

Ukraine's trade deficit is largest since 2008

Declining export revenues of Ukrainian steelmakers and rising imports intensify risks for domestic economy

Igor Zholonkivskiy
igor.zholonkivskiy@erstebank.ua

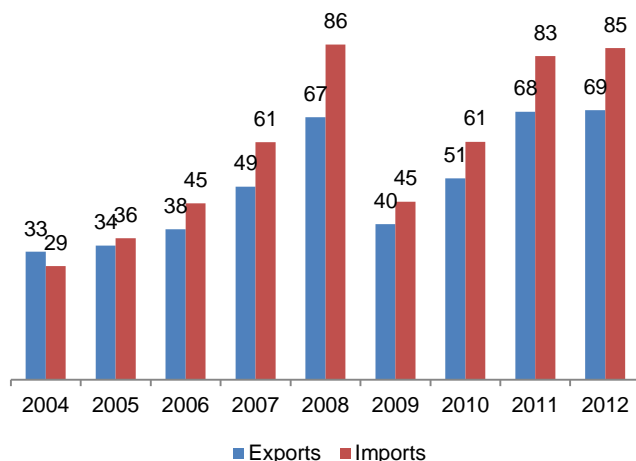
Ukraine's trade deficit widens to USD 15.8bn

In 2012, Ukraine's trade deficit increased 11.2% y/y to USD 15.8bn, the largest deficit since 2008. A trade disparity of such size makes the domestic currency exchange rate heavily dependent on external borrowings. In the case that unfavorable tendencies on the global steel market persist and external borrowing options become scarcer, the stability of the UAH exchange rate will be seriously threatened. Been there, done that – the current tendencies in the domestic economy look painfully similar to the times that preceded the hryvnia devaluation back in 2008. Ukraine's trade deficit had been widening steadily during several years prior to 2008, to the point where it had to be eventually offset by the devaluation of the hryvnia.

During 2003-08, global demand for steel was soaring, while the profits of Ukrainian steel exporters skyrocketed. Foreign capital found its way to Ukraine, new jobs were being created, and the population's income and standard of living had been gradually increasing. At the end of 2002, the average monthly salary in Ukraine was UAH 376 (USD 69), while at the end of 2007 it had risen to UAH 1351 (USD 250). Even when adjusted for inflation, the real income of a Ukrainian person had grown substantially during that period. People could then afford to purchase goods of superior quality, started taking loans to buy foreign-made cars, etc.

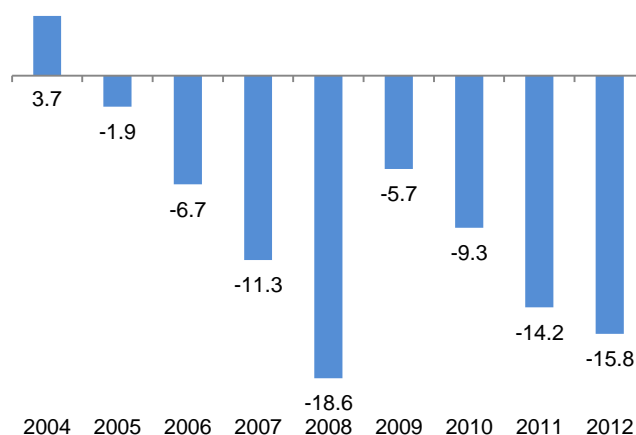
As a result, demand for imported goods had increased, while the quality of domestically made goods did not notably improve, thus leading to a further decline of demand. The trade deficit had been widening at an alarming rate up until the world financial crisis of 2008 and subsequent devaluation of the hryvnia. At the end of 2009, the physical volumes of imports fell by 46.5% y/y, on the back of exports declining 19%.

Export and import of goods, USD bn



Source: Ukrstat

Ukraine's trade balance, USD bn

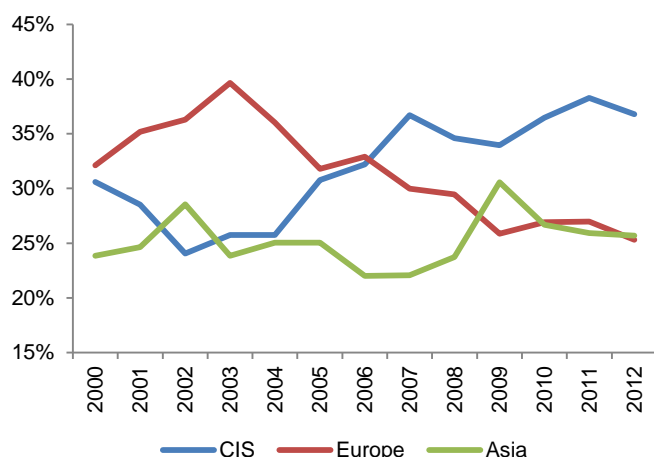


Source: NBU

Russia remains major market for Ukrainian exporters

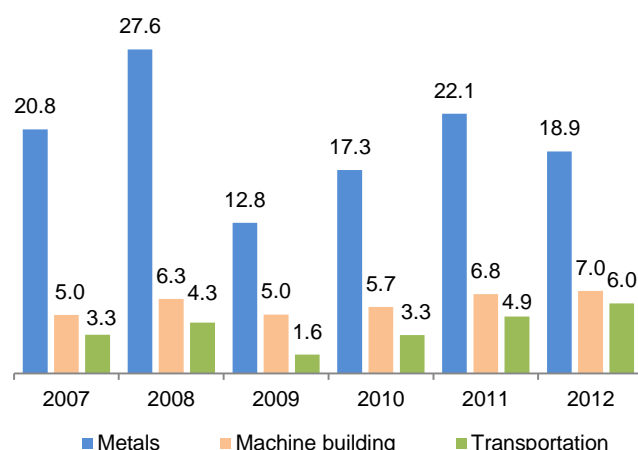
CIS countries, and Russia in particular, remain the most important market for Ukrainian exports. In 2012, exports to CIS countries constituted 36.8% of the total amount in monetary terms, while Asia and Europe accounted for 25.7% and 25.3%, respectively. The largest export volumes went to Russia – 25.6% of the total, mostly rail locomotives, black metals as well as machine building products.

Ukrainian exporters' revenue breakdown by region



Source: Ukrstat

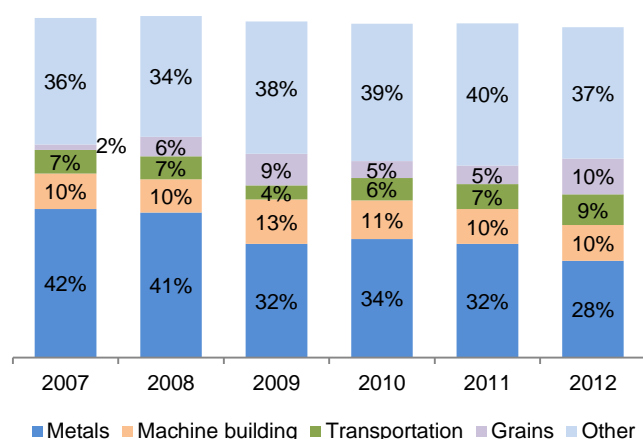
Ukrainian exporters' revenue breakdown by industry, USD bn



Source: Ukrstat

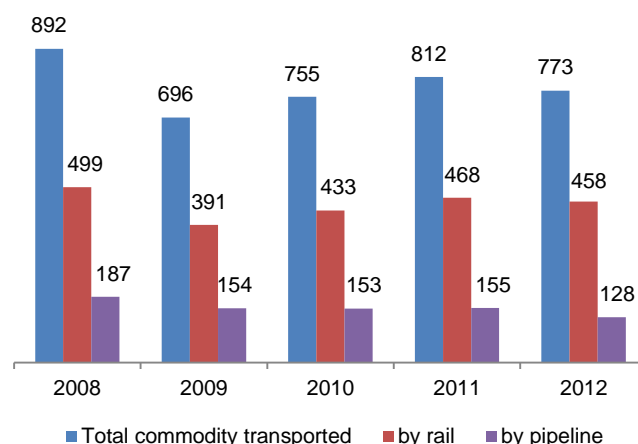
During the last 10 years, the share of export revenues coming from Europe has been steadily decreasing – from 40% in 2003 to 25% in 2012. One of the reasons for the decline is that traditional Ukrainian exports such as black metals and machine building products are becoming less competitive on the global level. Improving production technologies and the implementation of innovative approaches require substantial capital expenditures – something that many Ukrainian companies simply cannot afford.

Breakdown of Ukrainian exports by industry



Source: Ukrstat

Cargo volume transported, mn tonnes



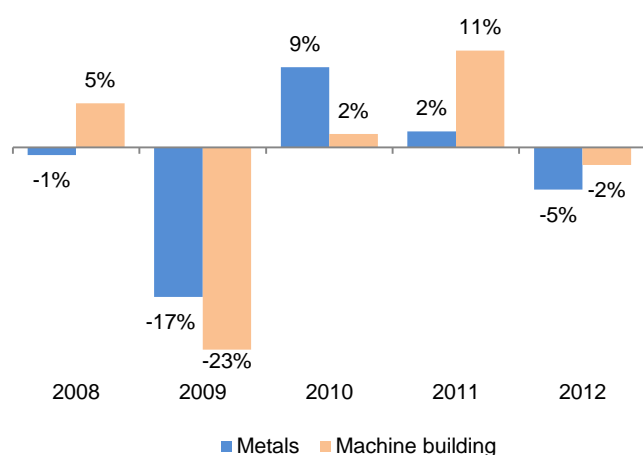
Source: Ukrstat

Since 2007, the share of black metals export revenues relative to total revenues has decreased from 42% to 28%. The decline was primarily caused by cooling world steel prices and the partial loss of market share to competitors. The slowdown of business activity in the Ukrainian economy became obvious during 2012. The volumes of cargo

transported in the country can serve as one of the indicators – in 2012, total cargo transported amounted to 773mn tonnes, a 5% decline y/y, and a 14.5% decline compared to 2008.

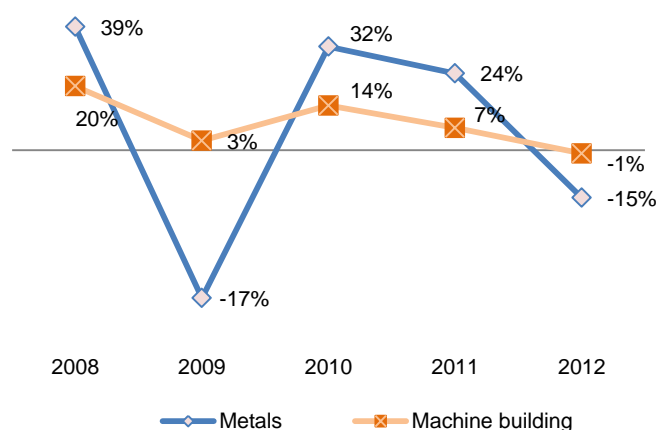
In 2012, the physical volume index of exported goods in the black metals and machine building industries declined by 5% and 2% y/y, respectively; this was the first decline since 2009. At the same time, average selling prices for the two industries declined by 15% y/y and 1% y/y, respectively.

Physical volumes of exports by industry, y/y



Source: Ukrstat

Price index dynamics by industry



Source: Ukrstat

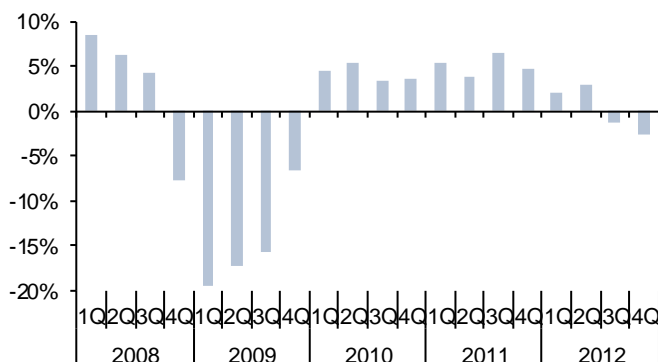
Foreign trade outlook

Apparently, some of the key challenges for Ukraine are going to be the preservation and expansion of its export market share. It is of vital importance to create conditions for free competition in the country and minimize obstacles for foreign trade activity. One extremely effective step would be to join a free trade zone with the EU, as it would reduce custom duties on Ukrainian products. It is also necessary to abandon the practice of enacting quotas on exports, especially for agriculture products.

When mentioning the program of import substitution, Ukrainian officials usually indicate the need for administrative restrictions, tariff increases and quota revisions in order to protect Ukrainian producers. In our opinion, Ukrainian producers require a completely different type of protection, namely a transparent and stable environment for doing business, the elimination of permanent pressure from tax collecting authorities, and the maximum simplification of the licensing system. The Ukrainian economy in its current state is extremely fragile and most vulnerable to fluctuations in external demand. In addition, there is a clear growing dependence on Russian markets, which automatically gives Russia a major geopolitical lever of influence over Ukraine.

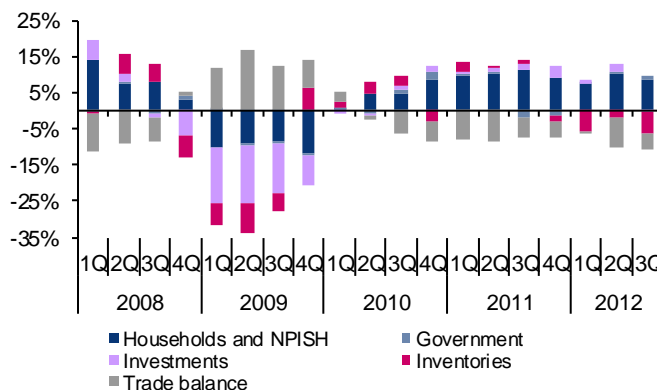
GDP

Real GDP, y/y



Source: Ukrstat

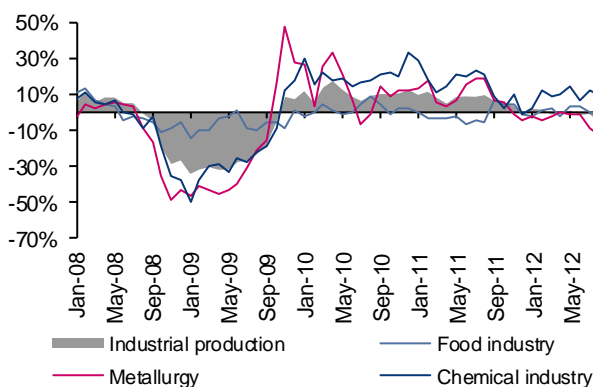
Contributions to real GDP growth



Source: Ukrstat

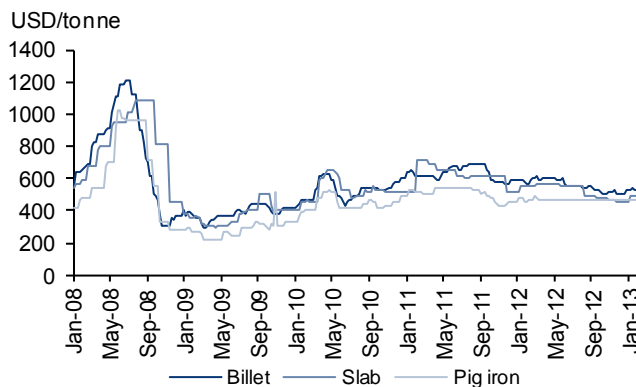
Industrial production and commodity prices

Industrial production, y/y



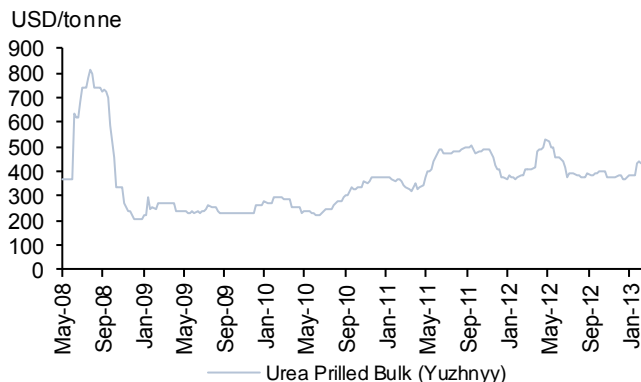
Source: Ukrstat

Steel prices



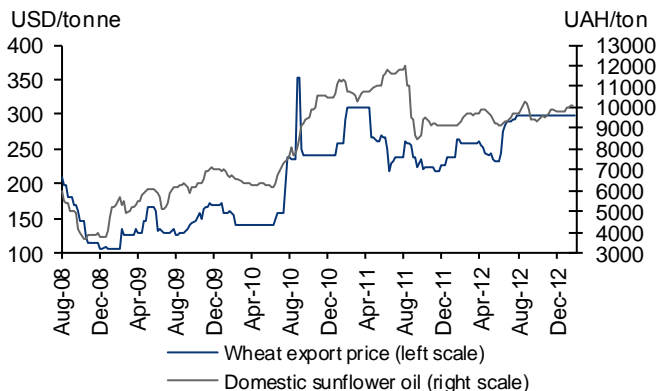
Source: Bloomberg

Fertilizer prices



Source: Bloomberg

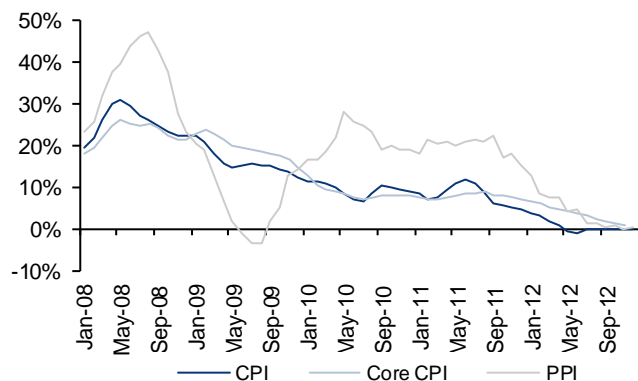
Wheat and sunflower oil prices



Source: Bloomberg

Inflation

CPI, core CPI, PPI



Source: Ukrstat

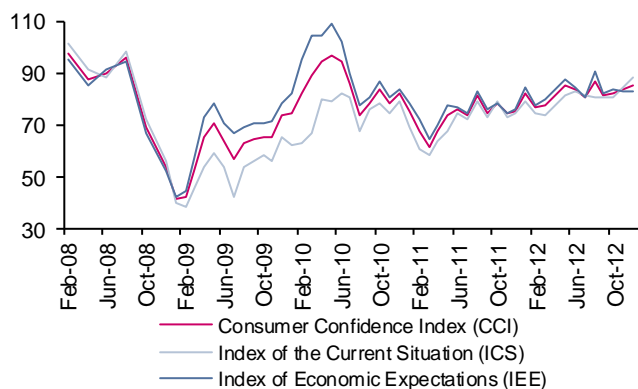
Export and import inflation



Source: Ukrstat

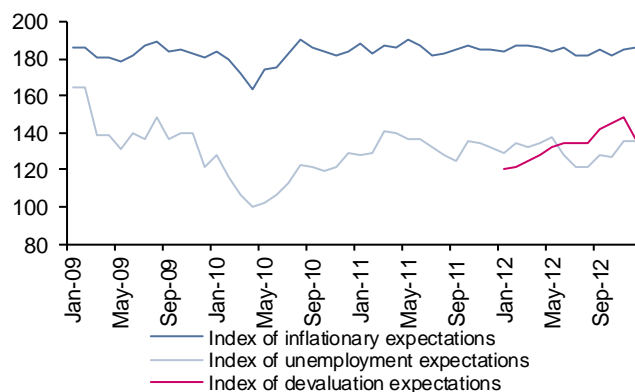
Consumer confidence

Consumer confidence indices



Source: GfK Ukraine

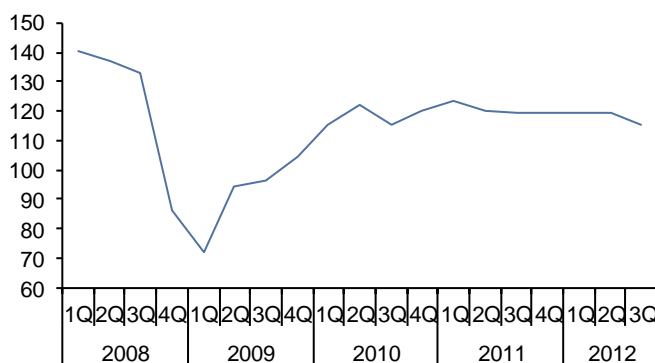
Consumer expectations



Source: GfK Ukraine

Business confidence

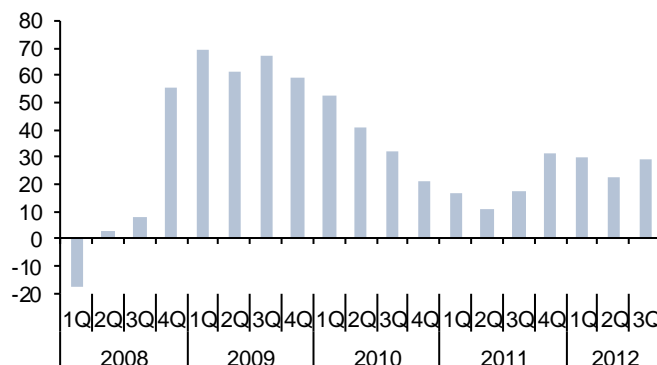
Business confidence



Source: NBU

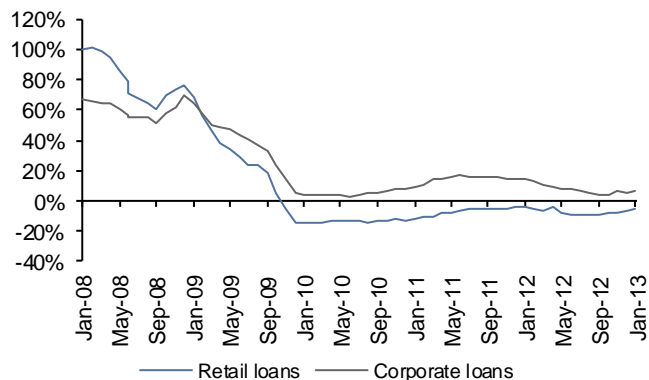
Loans

Corporates, toughness of credit conditions (+ is too tough)



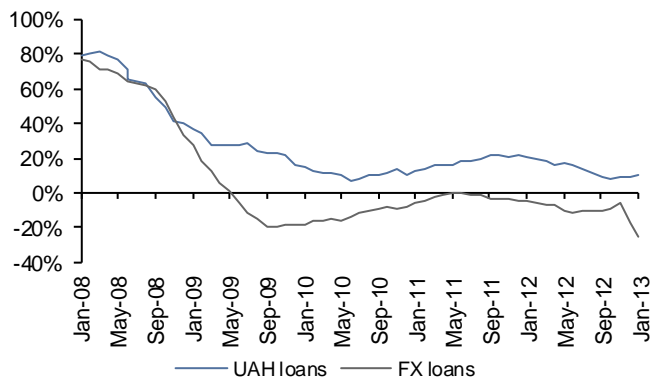
Source: NBU

Retail and corporate loans, y/y



Source: NBU

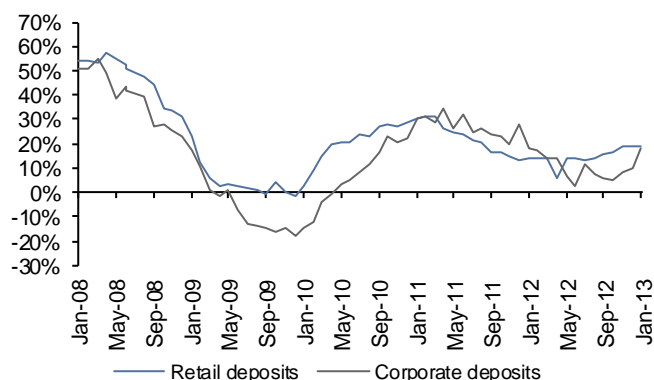
FX and UAH loans, y/y



Source: NBU

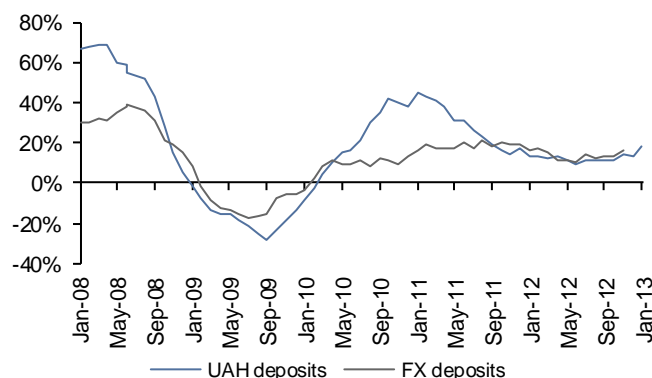
Deposits

Retail and corporate deposits, y/y



Source: NBU

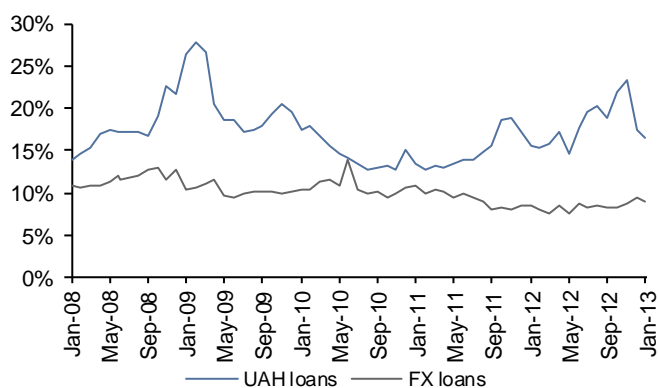
FX and UAH deposits, y/y



Source: NBU

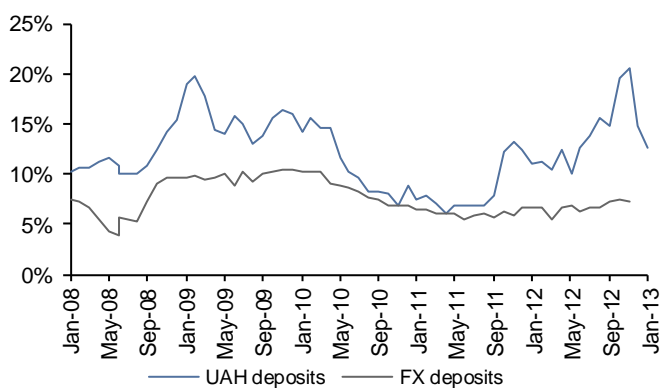
Interest rates

Loan interest rates



Source: NBU

Deposit interest rates



Source: NBU

Erste Bank Ukraine

Macro Report

21 February 2013

	2009	2010	2011	2012F	2013F	2014F
Nominal GDP (UAH bn)	913	1 083	1 317	1 313	1 516	1 698
Population (mn)	46.0	45.8	45.6	45.3	45.1	44.9
GDP per capita, PPP (USD)	6 330	6 697	7 199	7 271	7 453	7 751
Real GDP (y/y %)	-14.8	4.2	5.2	0.2	1.5	4.0
Private Consumption (y/y %)	-14.9	7.0	14.0	9.0	-2.0	2.0
Fixed Capital Formation (y/y %)	-50.5	4.9	9.0	8.0	-20.0	10.0
Nominal Wages (UAH)	1 906	2 239	2 633	2 804	3 141	3 455
Nominal Wages (y/y %)	4.0	17.5	17.6	6.5	12.0	10.0
Retail sales (y/y %)	-16.6	7.6	14.7	2.0	-2.0	2.0
Industrial production (y/y %)	-21.9	11.0	7.6	-1.8	-1.0	5.5
CPI (y/y, average %)	16.2	9.4	8.0	0.6	12.0	10.0
CPI (y/y, year-end %)	13.0	9.2	4.6	-0.1	14.0	8.0
Unemployment (%)	8.8	8.1	8.0	7.9	8.0	7.9
Trade balance (% of GDP)	-1.7	-2.9	-5.6	-9.6	-2.5	-2.2
Foreign direct investment (% of GDP)	3.8	4.3	4.2	4.0	5.0	5.0
Current account balance (% of GDP)	-1.7	-1.9	-5.6	-8.6	-1.9	-1.5
Govt. budget balance (% of GDP)	-6.3	-5.9	-2.6	-2.5	-2.0	-1.5
Public debt (% of GDP)	34.6	34.8	36.0	30.2	36.7	33.0
Foreign debt (% of GDP)	90.9	80.0	76.7	72.7	81.6	78.0
Central bank intervention rate, average	11.10	8.90	7.75	7.65	7.50	7.50
Central bank intervention rate, year-end	10.25	7.75	7.75	7.50	7.50	7.50
Short term interest rate 1M, average	17.97	7.72	10.20	13.90	12.25	9.25
Short term interest rate 1M, year-end	18.10	6.50	25.00	28.00	12.00	10.00
Long term interest rate 2Y, average	25.40	15.40	11.90	16.60	14.75	11.75
Long term interest rate 2Y, year-end	26.00	12.00	19.00	25.00	14.50	12.50
USD/UAH average	8.07	7.95	7.98	8.10	9.50	10.00
USD/UAH year-end	7.98	7.98	8.00	8.20	10.00	10.00
EUR/UAH average	11.34	10.51	11.11	10.13	12.50	12.50
EUR/UAH year-end	11.67	10.66	10.37	10.25	12.50	12.50
Outstanding Loans (UAH bn)	718	724	792	851	1 063	1 222
Outstanding Deposits (UAH bn)	328	414	497	535	710	816
Disposable income of households (UAH bn)	674	813	1 251	1 373	1 579	1 769
Savings rate (% of disposable income)	12.2	16.7	10.1	12.0	14.0	12.0

Treasury

Dmitriy Lazarev

Head of Treasury

38 044 585 92 33

Treasury Sales

Aleksandra Antsiunas

Head of division

38 044 593 17 80

Public relations

Olena Pavlovska

Head of division

38 044 585 67 49

Research

Igor Zholonkivskyi

Head of division

38 044 593 17 84

Inna Zvyagintseva

Analyst

38 044 593 91 88

This publication has been prepared by Erste Bank Research. This report is for information purposes only. Individuals who do not have professional experience in matters relating to investments should not rely on it. The information contained herein has been obtained from public sources believed by Erste Bank to be reliable, but which may not have been independently justified. No guarantees, representations or warranties are made as to its accuracy, completeness or suitability for any purpose. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument or any other action and will not form the basis or a part of any contract. Neither Erste Bank nor any of its affiliates, its respective directors, officers or employers accepts any liability whatsoever (in negligence or otherwise) for any loss howsoever arising from any use of this document or its contents or otherwise arising in connection therewith. Any opinion, estimate or projection expressed in this publication reflects the current judgement of the author(s) on the date of this report. They do not necessarily reflect the opinions of Erste Bank and are subject to change without notice. Erste Bank has no obligation to update, modify or amend this report or to otherwise notify a reader thereof in the event that any matter stated herein, or any opinion, projection, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. The past performance of financial instruments is not indicative of future results. No assurance can be given that any financial instrument or issuer described herein would yield favourable investment results. Erste Bank, its affiliates, principals or employees may have a long or short position or may transact in the financial instrument(s) referred to herein or may trade in such financial instruments with other customers on a principal basis. Erste Bank may act as a market maker in the financial instruments or companies discussed herein and may also perform or seek to perform investment banking services for those companies. Erste Bank may act upon or use the information or conclusion contained in this report before it is distributed to other persons. This report is subject to the copyright of Erste Bank. No part of this publication may be copied or redistributed to persons or firms other than the authorised recipient without the prior written consent of Erste Bank. By accepting this report, a recipient hereof agrees to be bound by the foregoing limitations.

Copyright: 2013 Erste Bank. All rights reserved. Please refer to www.erstebank.ua for the current list of specific disclosures and the breakdown of Erste Bank's investment recommendations.