

What will happen with utility prices?

Projected gas price increase will be very unequal among Ukraine's regions. Utility price rise is unlikely to happen even after the elections. GDP will not grow in 3Q.

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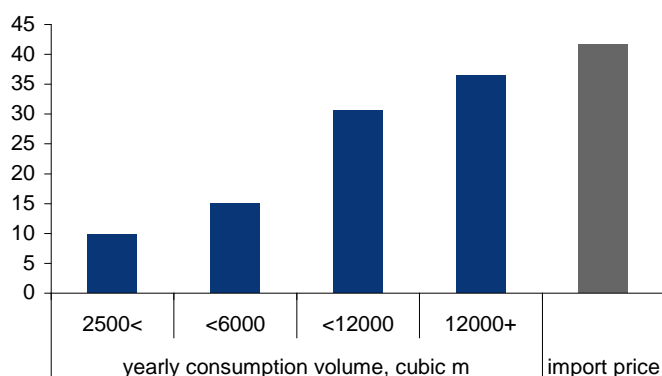
IMF demands strong retail energy price increase

IMF will visit Ukraine in September

On July 31 first deputy prime minister Valeriy Khoroshkovskiy met IMF director Christine Lagarde. According to Khoroshkovskiy's statement IMF mission will visit Ukraine in September. IMF and Ukraine will discuss state budget for 2013, in particular subsidies for gas and heating. IMF insists that government raises retail gas prices by 30% and water heating by 58%.

Most consumers pay less than quarter of gas cost

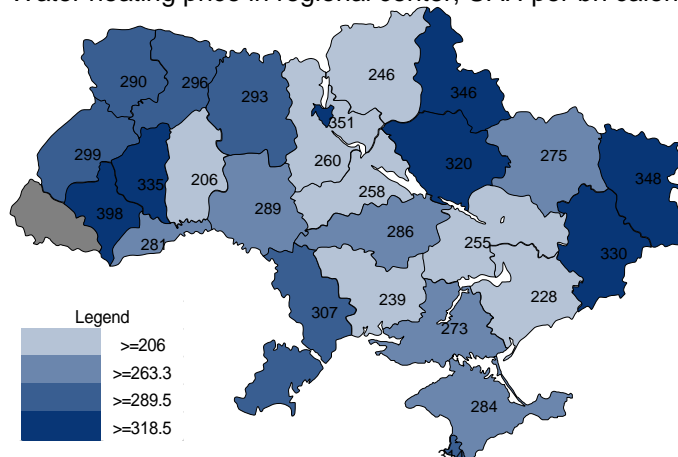
Retail gas price for population



Source: Naftogaz, National Commission for Regulation of Energy

Heating prices are very different among regions

Water heating price in regional center, UAH per bn calories



Source: Ministry of regional development and utility services

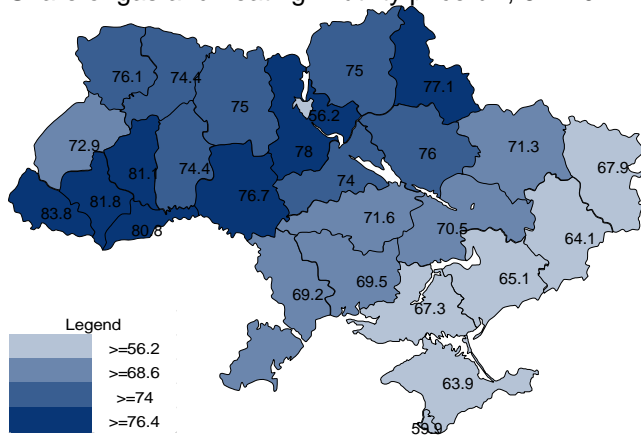
There's a great regional difference in terms of heating prices

Most consumers pay less than a quarter of the import price. The price difference is covered by private companies (which pay times more compared to population) and state budget. The gas prices are being equally subsidized for all retail consumers independent of their income. Gas makes 36% of the total utility services bill, another third relates to heating. Heating prices are very different across country. For example in Khmelnytsk one billion calories costs UAH 209 while in neighboring Ternopil UAH 335. On May 12 president Viktor Yanukovich made [public statement](#) ordering government to "create unified approach for utility prices". Increase of the utility prices creates more complicated, than it seems at first glance, problem as price increase will be very uneven across country. It will be hard to explain to population why some have seen a much stronger price increase than IMF demanded. Besides the share of gas and heating in total price bill is much higher in West of Ukraine than in the East. This is due to much lower wages in West and thus much higher relative costs of commodities. In Western regions gas and heating makes 75-80% of the total bill while in East makes only 65%. Thus Western

regions will suffer much more from the gas price rise. On the other hand, the debt for utility services in East is on average 4 months which is twice as high as in the West. Increasing prices will demand greater control for timely payments which will be more damaging for the East.

Western and Central regional will be hit hardest by gas and heating price rise

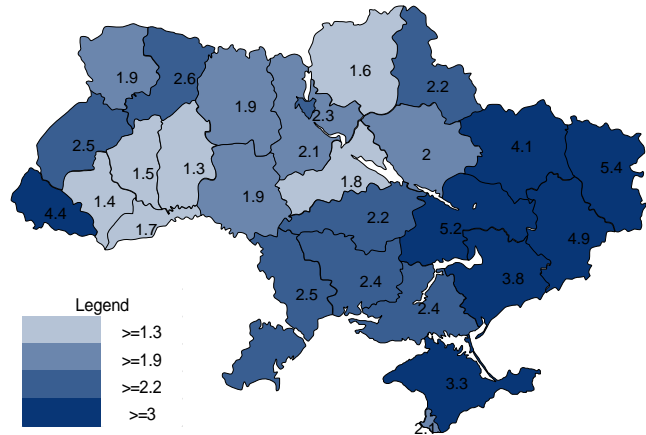
Share of gas and heating in utility price bill, 6M 2012



Source: Ukrstat

On East is the biggest debtor for utility services

Debt for Utility services, months, June 2012



Source: Ukrstat

Increasing retail energy prices will not lead to bigger investments into energy saving

Both IMF and government are not that much interested in cooperation as it was back in 2008

Chances of IMF program renewal are slim

Increasing gas prices isn't the goal itself for the IMF, its only an instrument which should stimulate investments into energy saving technologies. Increasing energy efficiency is IMF's key demand as it wants Ukraine to decrease oil and gas imports and thus improve its balance of payments and fiscal situation. Yet investments into energy saving technologies can't be currently effectively done due to very high interest rates on loans. High interest rates are in turn a result of fixed hryvnia exchange rate. Moving to a more flexible rate may imply devaluation and thus even greater difference between the gas import and retail price. There are also restrictions in legislation that forbid a single household to disconnect from a centralized heating system. Banks find it difficult to credit private organization uniting apartment owners due to their status of unprofitable organization. With fixed exchange rate and current legislation increase in gas prices will not lead to desirable effects. Along with price increase there should be a complex program of utility sector reform and exchange rate liberalization. At least until parliamentary elections in late October the ruling coalition will not go forward with unpopular steps. Yet even after the elections chances for dramatic reforms and quick resumption of cooperation with IMF are slim. Obstacles are not only it big technical complexity of the issue and it's political sensitivity. Currently government does not need IMF help as its able to borrow on external markets. Having IMF program on track would at best make borrowings 1-2% cheaper. As long as Ukraine is not in a financial crisis and government is not cut from external borrowings there are no urgent reasons to accept IMF help. Even if Ukraine would get into financial troubles, IMF loans are really interesting if they can cover budget shortfall. IMF will not be interested in crediting state budget at least due to three reasons: high expenses of fighting EU debt crisis, bad experience of cooperation with Ukraine in the recent years, sharp decline in loans granted by Western banks to Ukrainian residents. Western banks' loans declined from pre-crisis USD 58bn to the current USD 36bn. Ukraine does not present such a big threat to global financial system as in the past. Most likely that even after the elections utility prices will remain unchanged. Thus its unlikely that IMF program will resume in the near future.

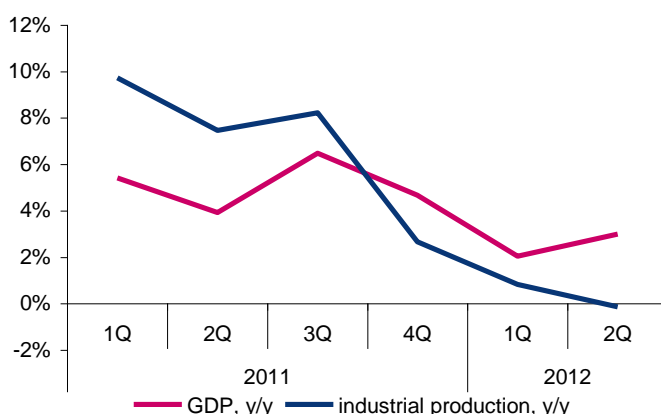
GDP growth surprised on the upside

EURO 2012 and lower inflation helped GDP in 2Q

Real GDP grew 3% y/y in 2Q. The data was a positive surprise as industrial production was in decline. GDP was boosted by investments into EURO 2012 and increased domestic demand. In 1Q real retail trade grew by 12% y/y, in 2Q growth accelerated to 15%. Reason behind household consumption growth were tourist inflows for EURO 2012 and lower inflation which boosted demand.

Despite decline in industrial production, GDP growth was substantial

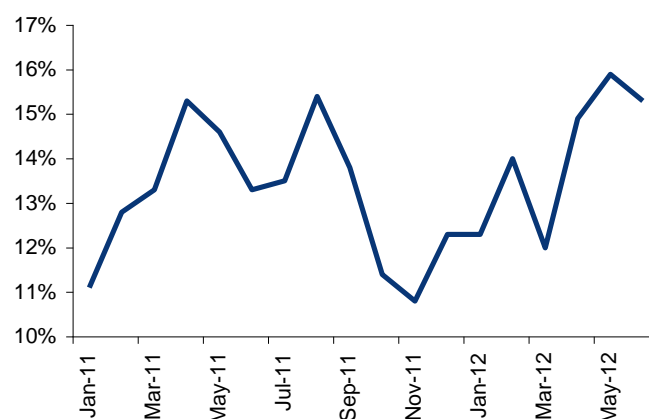
Real GDP and industrial production



Source: Ukrstat

Domestic demand grew strongly in 2Q

Real retail trade, y/y



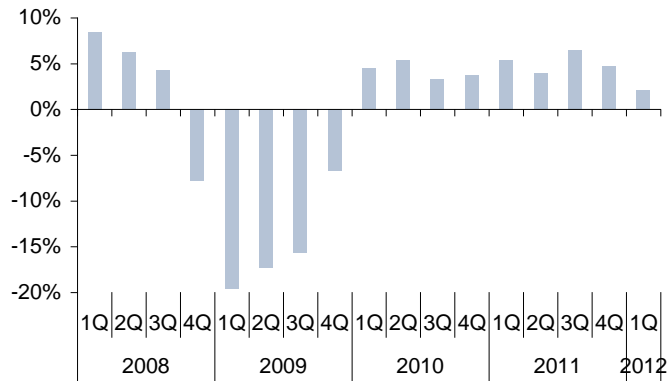
Source: Ukrstat

GDP will show zero growth in 3Q

Inflation will rise in 3Q as grain harvest will be lower this year. Investments will also shrink due to further rise in interest rates and end of the EURO 2012 investments. Industrial production downward trend is unlikely to improve due to further deterioration of global economy. Real GDP will not grow in 3Q in y/y terms.

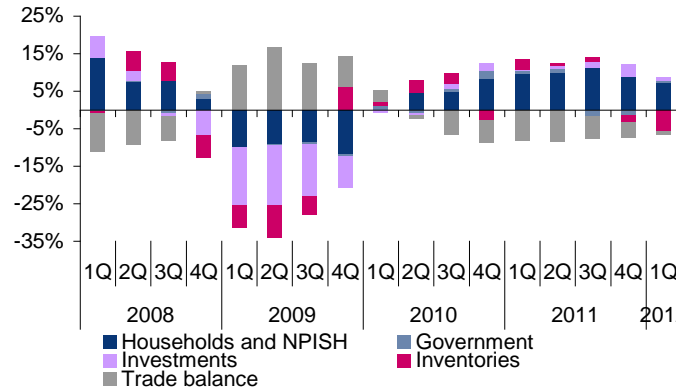
GDP

Real GDP, y/y



Source: Ukrstat

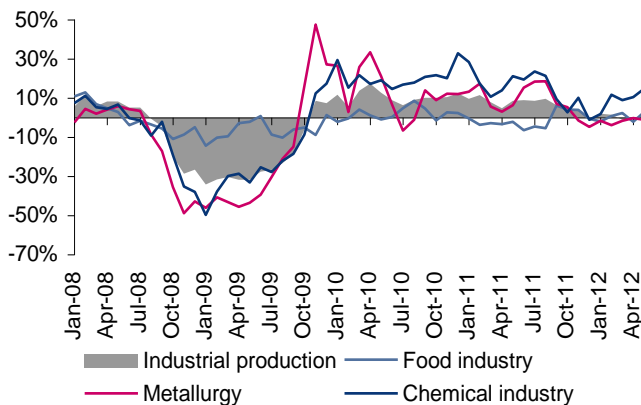
Contributions to real GDP growth



Source: Ukrstat

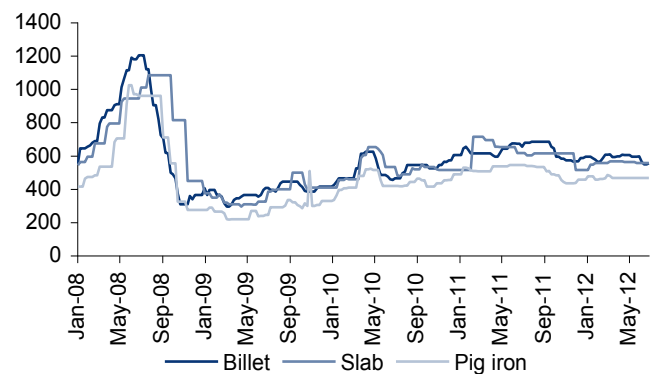
Industrial production and commodity prices

Industrial production, y/y



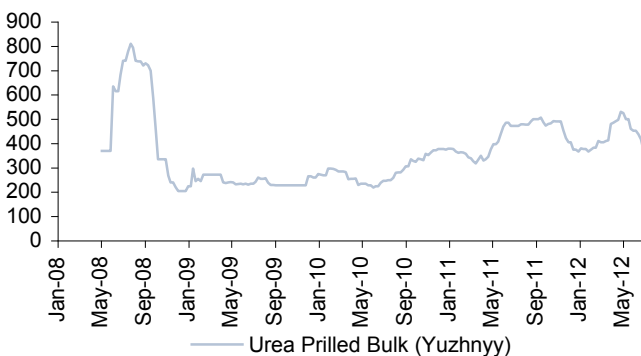
Source: Ukrstat

Steel prices



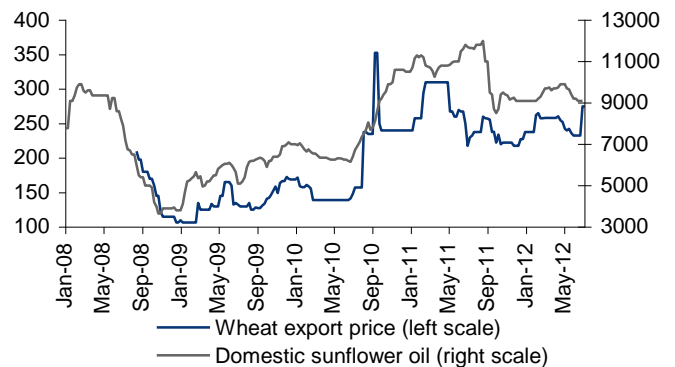
Source: Bloomberg

Fertilizer prices



Source: Bloomberg

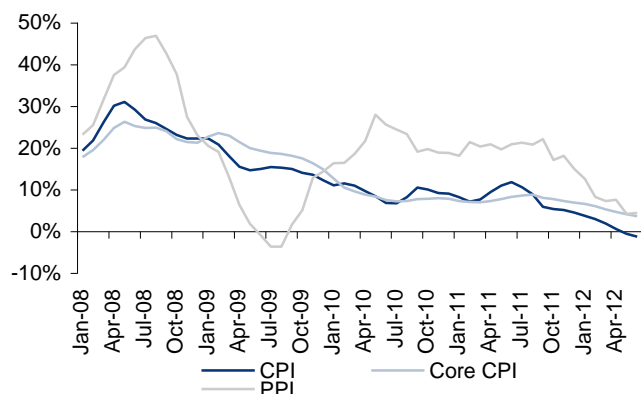
Wheat and sunflower oil prices



Source: Bloomberg

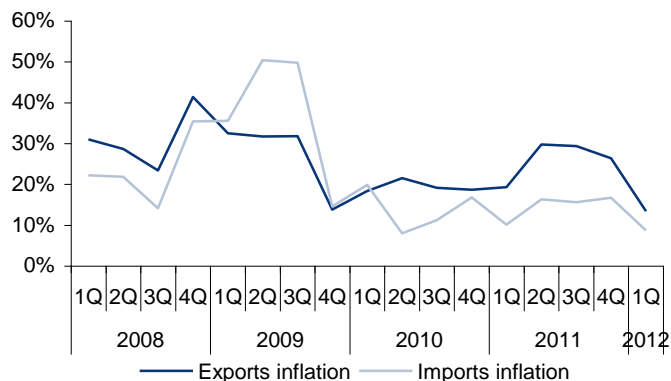
Inflation

CPI, core CPI, PPI



Source: Ukrstat

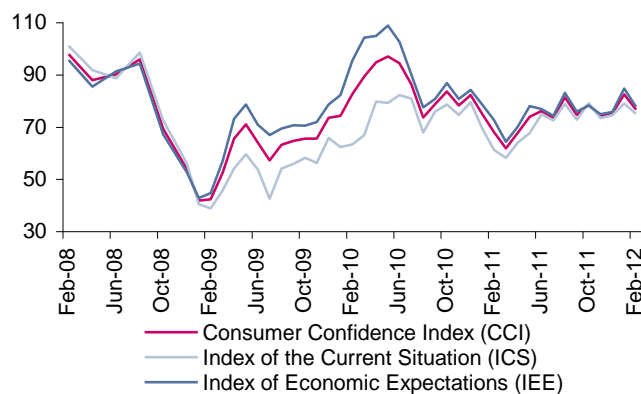
Exports and imports inflation



Source: Ukrstat

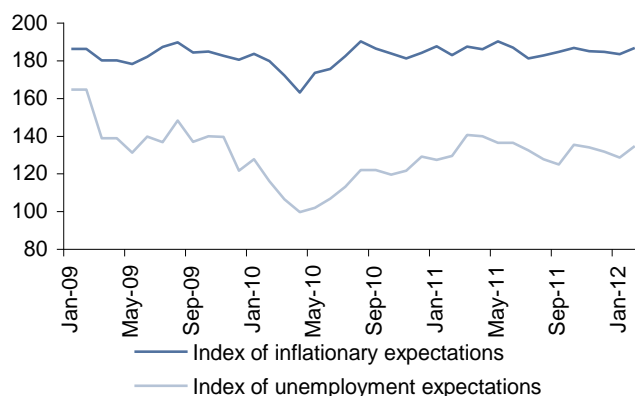
Consumer confidence

Consumer confidence indexes



Source: GfK Ukraine

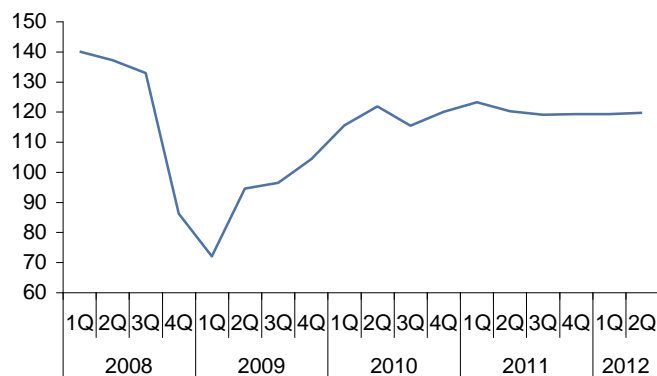
Consumer expectations



Source: GfK Ukraine

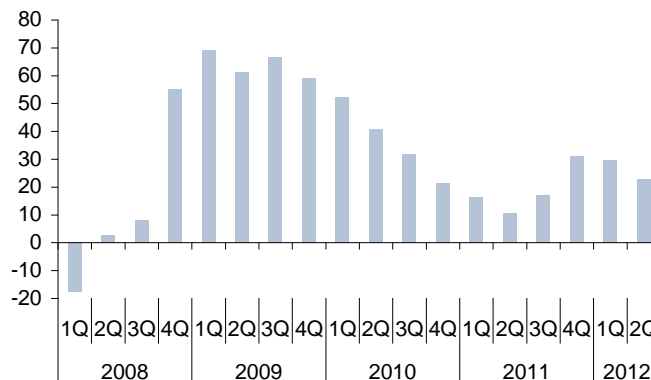
Business confidence

Business confidence



Source: NBU

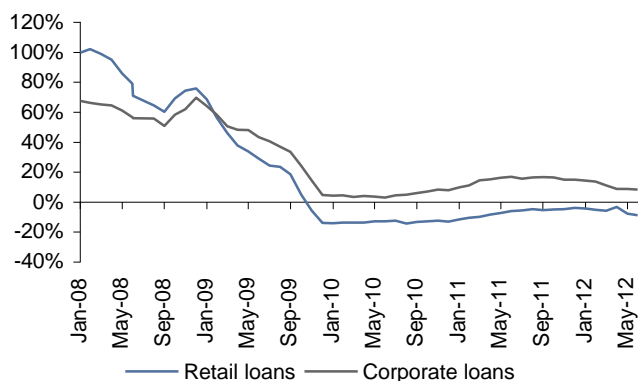
Corporates, toughness of credit conditions (+ is too tough)



Source: NBU

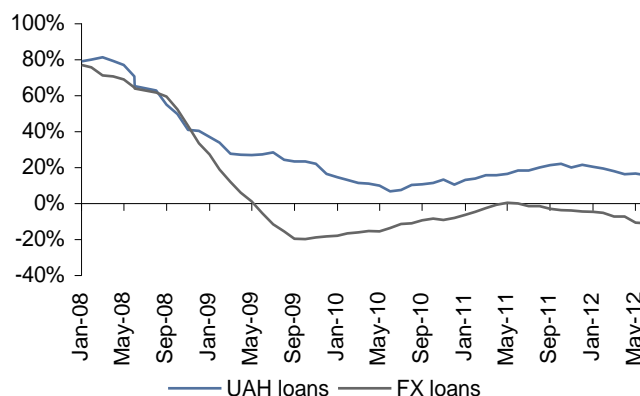
Loans

Retail and corporate loans, y/y



Source: NBU

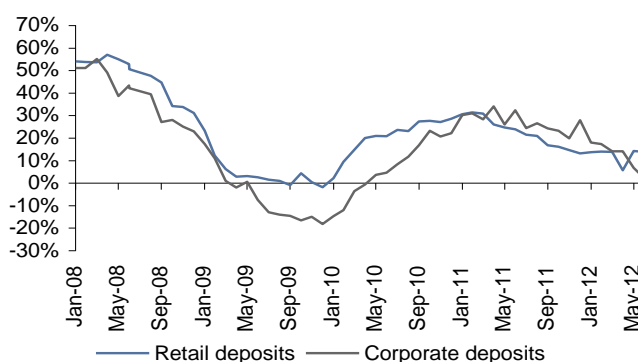
FX and UAH loans, y/y



Source: NBU

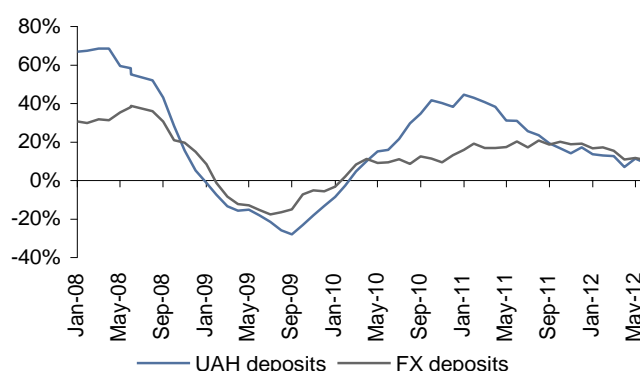
Deposits

Retail and corporate deposits, y/y



Source: NBU

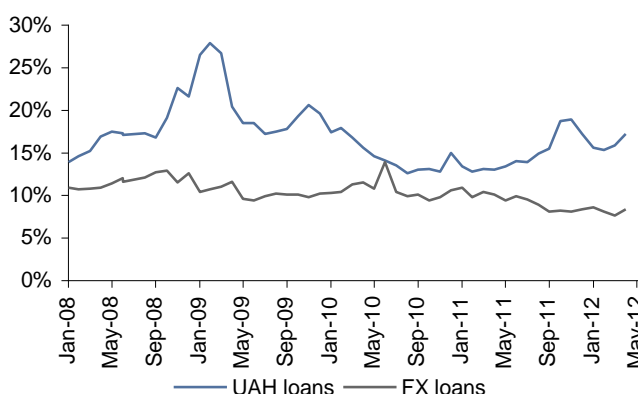
FX and UAH deposits, y/y



Source: NBU

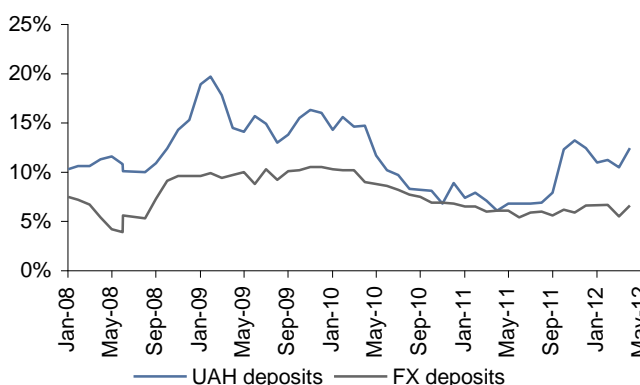
Interest rates

Loan interest rates



Source: NBU

Deposit interest rates



Source: NBU

Macro forecasts

	2008	2009	2010	2011	2012F	2013F
Nominal GDP (UAH bn)	948	915	1 095	1 314	1 386	1 622
Population (mn)	46.1	46.0	45.8	45.6	45.3	45.1
GDP per capita (UAH)	1 928	1 704	2 243	2 777	2 831	2 740
Real GDP (y/y %)	2.3	-14.8	4.2	5.2	1.0	3.0
Private Consumption (y/y %)	12.0	-14.9	7.0	14.0	2.0	-2.0
Fixed Capital Formation (y/y %)	2.0	-50.5	4.9	9.0	5.0	-20.0
Nominal Wages (UAH)	1 806	1 906	2 239	2 633	2 804	3 141
Nominal Wages (y/y %)	33.7	4.0	17.5	17.6	6.5	12.0
Retail sales (y/y %)	18.6	-16.6	7.6	14.7	2.0	-2.0
Industrial production (y/y %)	-3.1	-21.9	11.0	7.6	-1.0	4.0
CPI (y/y, average %)	25.2	16.2	9.4	8.0	1.1	12.0
CPI (y/y, year-end %)	22.3	13.0	9.2	4.6	3.0	14.0
Unemployment (%)	6.4	8.8	8.1	8.0	7.9	8.0
Exports fob (UAH, bn)	449	438	551	708	675	797
Imports cif (UAH, bn)	525	454	582	782	807	795
Trade balance (% of GDP)	-7.9	-1.7	-2.9	-5.6	-9.6	0.1
Foreign direct investment (% of GDP)	6.1	3.8	4.3	4.2	4.0	5.0
Current account balance (% of GDP)	-6.7	-1.7	-1.9	-5.6	-8.6	1.1
Govt. budget balance (% of GDP)	-1.2	-6.3	-5.9	-2.6	-2.5	-2.0
Public debt (% of GDP)	20.0	34.6	42.0	30.6	30.2	30.8
Foreign debt (% of GDP)	55.4	90.9	80.0	76.7	72.7	81.6
Central bank intervention rate, average	12.00	11.10	8.90	7.75	7.65	7.50
Central bank intervention rate, year-end	12.00	10.25	7.75	7.75	7.50	7.50
Short term interest rate 1M, average	14.80	17.97	7.72	10.20	13.90	12.25
Short term interest rate 1M, year-end	23.60	18.10	6.50	25.00	28.00	12.00
Long term interest rate 2Y, average	12.90	25.40	15.40	11.90	16.60	14.75
Long term interest rate 2Y, year-end	25.00	26.00	12.00	19.00	25.00	14.50
USD/UAH average	5.25	8.07	7.95	7.98	8.00	10.50
USD/UAH year-end	7.80	7.98	7.98	8.00	8.00	10.50
EUR/UAH average	7.67	11.34	10.51	11.11	10.80	13.13
EUR/UAH year-end	10.67	11.67	10.66	10.37	10.80	13.13
Outstanding Loans (UAH bn)	734	718	724	792	851	1 063
Outstanding Deposits (UAH bn)	358	328	414	497	535	710
Disposable income of households (UAH bn)	638	674	813	1 251	1 373	1 579
Savings rate (% of disposable income)	10.6	12.2	16.7	10.1	11.0	14.0

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