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JSC VABank Macroeconomic and Financial Market Outlook (Quarterly Update: 3Q 2006)

Friday, 11 August 2006

Summary

VABank Macroeconomic and Exchange Rate Forecasts

	2004 (December)	2005 (December)	2006 (I Q)	2006 (II H)	2006 (December)
UAH/USD	5,31	5,05	5,05	5,05	5,05
UAH/euro	6,91	6,07	6,19	6,46	7,03
Real GDP growth (%, y/y)	12,0	2,6	2,4	5,0	5,7
Industrial output (%, y/y)	12,5	3,1	0,2	3,2	6,5
CPI (%, y/y)	12,3	10,3	8,6	6,7	9,9
PPI (%, y/y)	24,1	9,6	6,5	6,3	11,2
Current account (as % of GDP)	10,4	3,8			-0,9

Almost all assumptions of our macroeconomic outlook (January, 20, 2006) have been confirmed in 2Q2006, in particular:

- GDP growth has reached exactly the figure we forecasted earlier this year for 1H2006 - 5%
- Domestic UAH interest rates have in general not declined due to higher demand for long-term resources
- Annual inflation was declining prior to June and real interest rates remained high; private savings were still more oriented on foreign currency deposits
- Money growth remained slow (base money dropped 0.7% during 7M2006 YTD), but accelerated resulting from NBU positive interventions
- Banks continued to aggressively expand their retail loans portfolio
- NBU negative forex interventions turned to positive
- Bank loans and assets grew at much slower rates, than in 2005
- Machine-building sector continued to accelerate, reaching 12% for 7M2006
- Issuance of bonds remained high, being concentrated on retail and building sectors

Friday, 11 August 2006

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Macroeconomics

GDP

Real GDP growth in 1H2006 reached exactly the figure, we forecasted in January outlook (5%), although it was slightly higher than our revised figure (4%). Other official forecasts have also been revised: government forecast has been upgraded to 7%, while IMF has upgraded its forecast to 5.2% from 2%.

We attribute such an acceleration in GDP dynamics to growing building, agricultural and retail sectors, improved exports (preliminary NBU data have shown exports' positive dynamics in May and June) due to recovery in world steel prices, low impact of gas price hike on many industrial enterprises and finally, decrease in annual inflation.

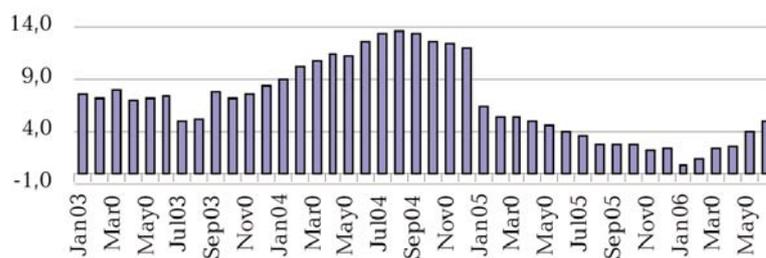
Negative factors of GDP dynamics were: growing demand for imports, pushing imports of durable goods by another 16% YTD; investments in fixed capital formation have accelerated (15,1% in 1Q2006 and are likely to reach 18-20% in 1H2006); private consumption continued to accelerate, which is confirmed by record retail sales growth of 27% for 6M2006.

We retain our forecast of GDP growth in 2006 at the level of 5.7%, as it was forecasted initially in our January Outlook. Its nominal value will grow at fast rate, but annual CPI acceleration by another 2.5-3% by the end of year (see Prices) will erode GDP real growth.

Prices

Annual **CPI** continued deceleration, stemming from higher base (last year's consumer inflation exceeded 14% in mid-year) Annual CPI in June made 6,7%. The reason of lower inflation level was decline in non-food and durable good component of the CPI, in part due to increased imports of those goods. Food items have been also growing slowly, resulting from meat price deflation (the latter grew extremely fast in 2005) and milk items prices. Sugar prices have shown one the highest growth rate in the CPI basket, growing 28,3% for 6M2006, which is rather justified on the background of world price acceleration - in mid-2006 sugar prices reached the record 24 years figure. Introduction of import 50% quote has cut sugar imports almost 15%, while exports and domestic prices are expected to grow, thus the prices.

Real GDP (% to previous year , cumulative)



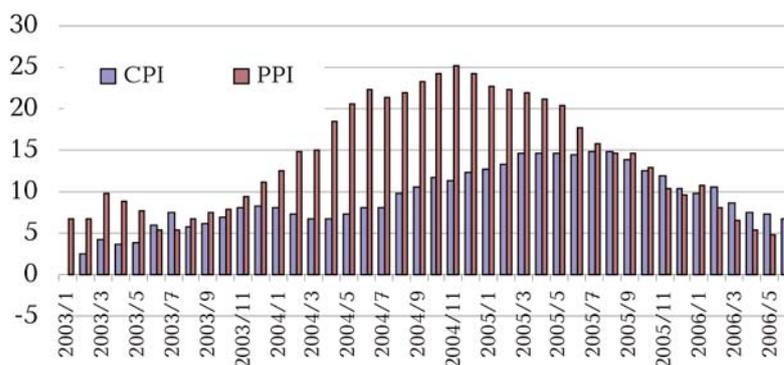
Source: State Statistics Committee

The factor exerting pressure on CPI was growth in prices on services, which grew at the highest rate in 1H2006. It resulted mainly from administrative price increase on railway transport (26,6%, which occurred in June) and public utilities (5,6%). In the following months of 2006, prices on services are likely to continue growth, which will be caused by further administrative price increase on public utilities, in particular electric power and gas. It will push prices to grow further, especially in September and subsequent months. However, the lower base of late 2006 will hold the annual CPI level in grip.

Based on results of 1H2006 we revise our forecast of consumer price inflation to lower level of 9,9% as for the end of 2006; producer price index will grow under impact of growing foreign demand on metallurgy, which will affect domestic prices. Our PPI forecast remains unchanged - 9,1%.

Prices in industry (PPI) grew 0,7% in June and make 6,33% annually. Their growth is triggered mainly by proceeding price growth on the products of coke and oil-refinery (+2,5%) in terms of gradually growing demand for products of metallurgy (+1,4%), shifting their production from gas to coke. Annual PPI hike in June is also attributed to base effect, when prices in mid-2005 were decreasing rather fast. Further price hikes in steel (+5,6% YTD) industry, coke & oil-refinery (+9,1% YTD) at a similar rate in 2H2006 are likely and will result from the higher world demand for steel production.

Prices in 2003-2006 (% , y-o-y)

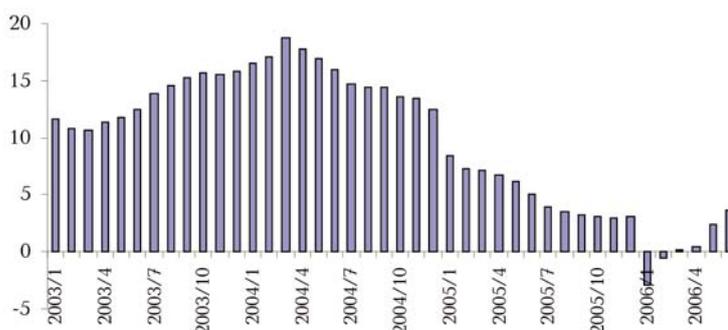


Source: State Statistics Committee, VABank calculations

Industrial growth

After reaching negative value for the first time in 7 years in January and February, industrial dynamics showed positive, though lower than we forecasted (5,2%), value of 3,6% for 6M2006. Growth has especially accelerated in June, mainly in extractive industry as world demand soared. It is noteworthy, that official financial results of the enterprises have in general been worse than for 1H2005.

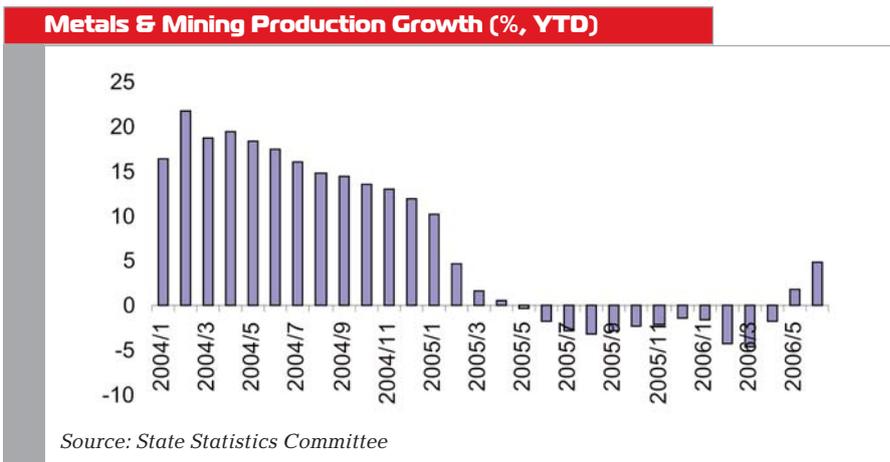
Industrial Production Growth (% to prev.year, YTD cumulative)



Source: State Statistics Committee

Metals & Mining

World demand continued to grow in 2Q06. It is projected to grow in the 3Q06 as high demand in auto industry, especially in Europe, and industrial consumption growth in China are currently observed. Flat steel prices are expected to grow another USD 50 in 2Q06 and stabilize by the end of year, with possibility of decrease in early 2007. Major Ukrainian producers have increased their steel output by 4,8% in 6M2006, thus bringing the figure of industrial production to higher than expected value of 3,6%. Such a positive impact on growth stemmed from exports, which rose 6,8% for 6M2006 to 15,6 mln tons. However, in price terms, revenues in USD dropped 5,2% for 6M2006 y/y, which was the result of crowding out many enterprises by over-production in China, becoming the additional factor that negatively affected trade balance on goods.

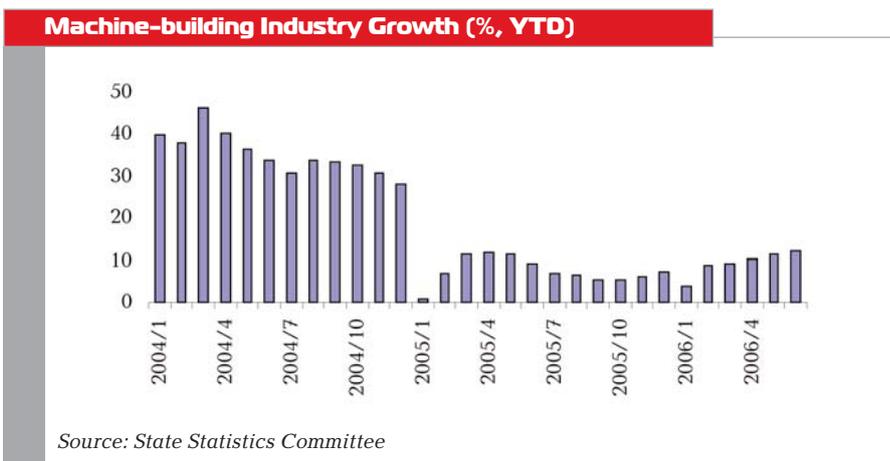


Steel production turned positive only in May, which previously caused the deceleration in declining exports.

Our outlook for industry remains positive, with y/y growth accelerating further but slowing down under the impact of declining world demand in 4Q2006, resulting in annual output growth of 9-11,5%.

Machine-building

Production in this industry is still far from the record level of growth, which has been registered in 2004. 1H2006 has showed 12.2% growth rate and it is likely to proceed further as both domestic consumer lending is driving the purchase of cars (domestic production of cars was even higher in 2Q2006; almost 50% of them were purchased on credit) and world demand for machinery production is accelerating, which is reflected in 60% growth of transport vehicle exports and more than triple growth rate in aviation and spacecraft exports.

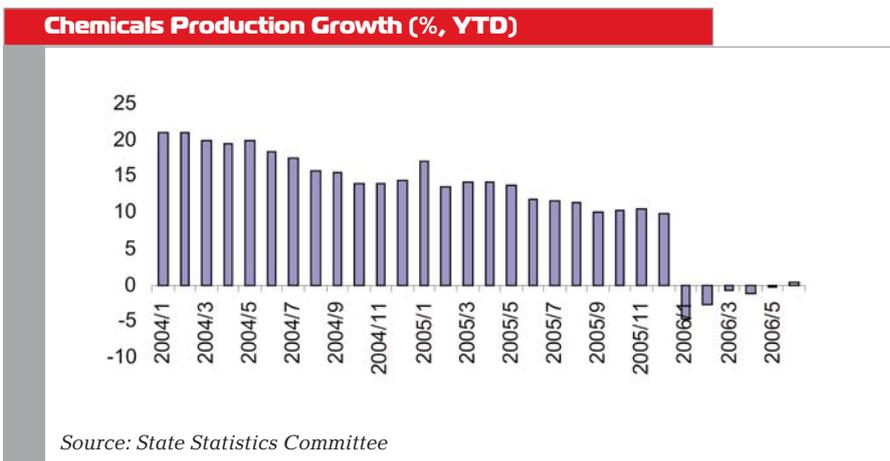


Production of buses continued to grow and reached 1931 (after 1506 in 1Q2006). Despite robust cars' import growth, 1,5-times increase in domestic production has been registered in 2Q2006 y/y.

Chemicals

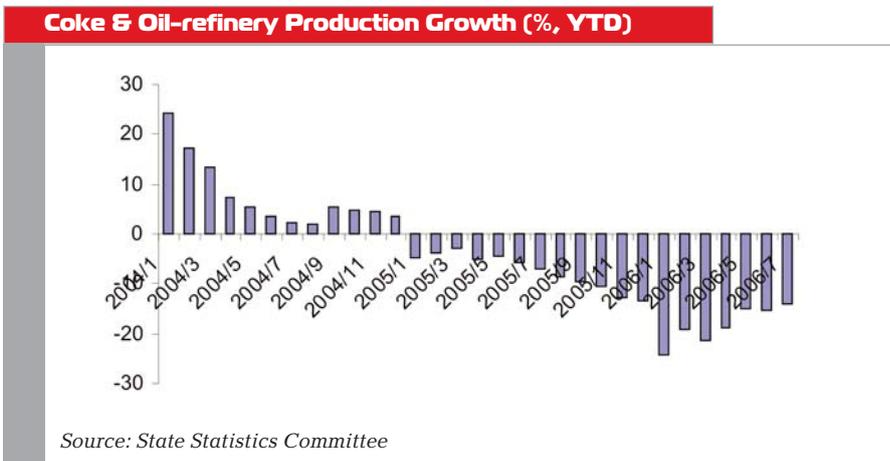
In early 2006 chemical industry, which occupies around 11% of the total domestic gas consumption and where gas takes some 40-65% in production costs, was affected by gas price hike. It began, however, to recover in June as export demand grew, boosting export volumes in this sector by 11%.

The main sources of revenues in chemical sector were from Naftogas, Stinol, Cherkassy Azot. The latter two have shown immense profit growth and paid the dividends (Stinol's profit was UAH 125 mln; while Azot's profit UAH 27,1 mln. We retain our forecast of annual 4-5% growth in this sector.



Coke and Oil-refinery

Starting from April, prices in this sector have been showing steady growth, totaling 9,5% YTD for 7M06. In the meanwhile, production remained negative, dropping 13,9% for 7M2006. The main reason for such a decline was high transportation tariffs, making export deliveries unfeasible and increasing imports mainly by Mittal Steel Kryvy Rig, (planning to import as much as 900 ths tons, with main motive being the low quality of domestic coke). Both state subventions in coke-producing sector and high domestic production costs, 90% of which fall on coked coal, exert the pressure on prices to grow further.



The domestic demand for coke is thus expected to grow slowly, spurred mainly by increased consumption of steel mills under the impact of current growth in world demand.

Building & Construction

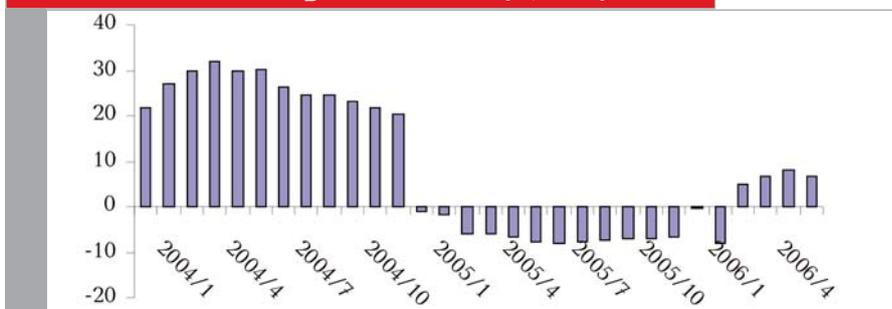
Value added in the sector continued to remain high, reaching 6.5% for 6M2006.

It is noteworthy, that officially registered profits of building enterprises have shown lower value in 1H2006, as compared to the last 2 years. It may be attributed to the necessity of raising more funds by building enterprises in form of loans (increasing their interest payments and pushing them to issue more convertible bonds), mainly long-term, whose proportion in the total loans to this sector exceeds 64%.

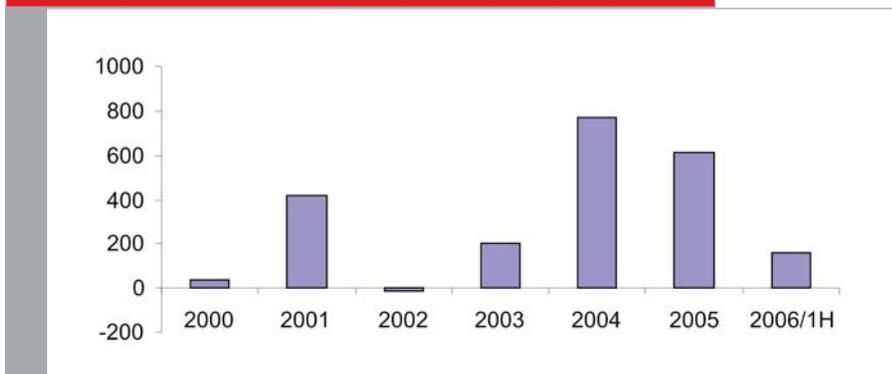
Price dynamics for building & construction works, in line with overall price dynamics, has decelerated, though remained high driven by high domestic demand. Deflation in this sector is unlikely while the demand will remain on a rather high level.

The demand will, however, shift to the smaller cities, where industrial dynamics has traditionally been slower. The largest industrial cities have been showing deceleration in growth of building, the prices stopped rising at dramatic rates, registered in 2005. Thus, prices for residential building in Kiev, where real estate in the last 2 years performed the investment function, grew some 14% for 7M2006 (as compared to more than 50% growth in 2005) and supply of residential building was up only 5.1% for 1Q06, as compared to tremendous triple growth in 1Q05.

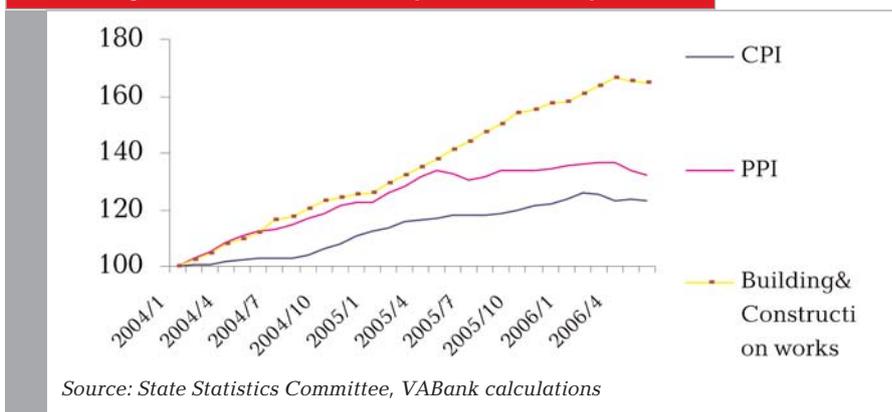
Value added in Building&Construction (% , YTD)



Profits/losses of building companies (UAH, mln)



Price Dynamics in 2005-2006 (Jan2004=100)



Source: State Statistics Committee, VABank calculations

Building companies, stimulated by growing competition and necessity of further fixed capital investments, continued increasing their debt. It was more concentrated on issuing zero-coupon convertible bonds, which provided almost half of their fixed capital investments. As much as UAH 4.5 bln (almost USD 1 bln) worth of convertible building bonds have been issued so far.

Private incomes and consumption

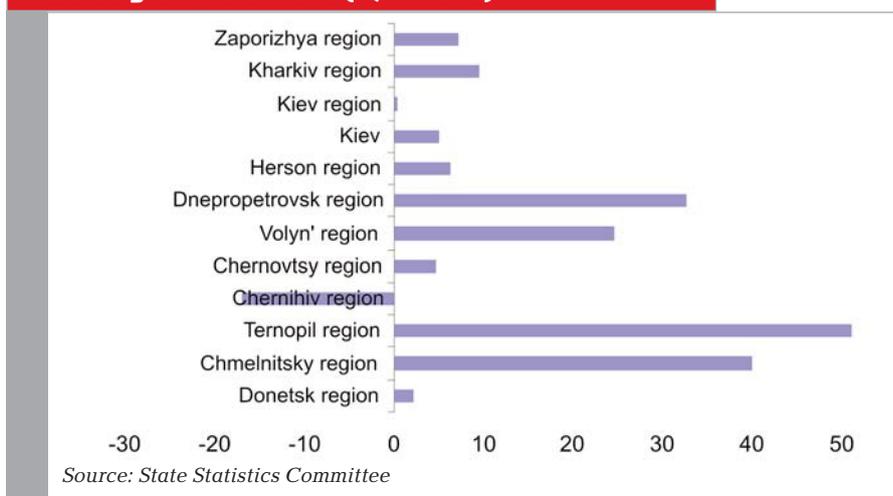
Real disposable incomes growth displayed some deceleration, but remained rather high growing 20% for 1H2006. Declining annual CPI figure contributed to the high growth value, but upwards dynamics in CPI since July will continue deceleration in the real disposable income growth to earlier forecasted value of 7-12% based on results of 2006.

It was due to the following factors:

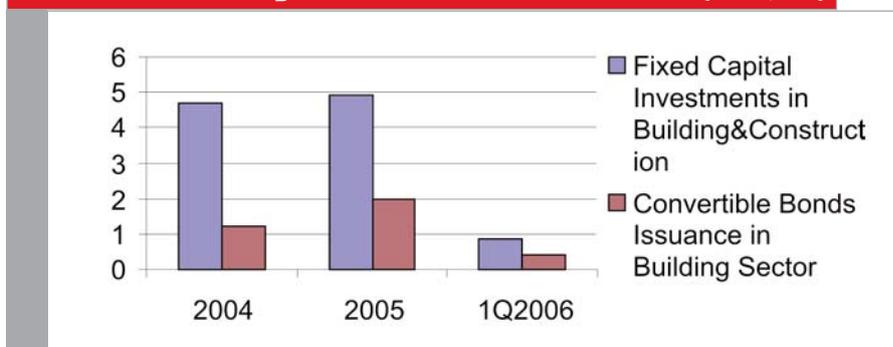
- The highest growth registered in property incomes (almost 40% y/y), while nominal wage grew 31% y/y.
- Active accumulation of the foreign currency by individuals, which as for early August 2006, exceeded the equivalent of USD 3,4 bln (since September 2006).
- Declining annual CPI, which is the basis for its calculation, prior to July.

We retain our forecast of deceleration in real disposable income dynamics in 2006 to 7-12% as private deposits will grow faster, CPI figure will show y/y upwards dynamics in 3Q06 and nominal wage growth will decelerate under the impact of declining productivity.

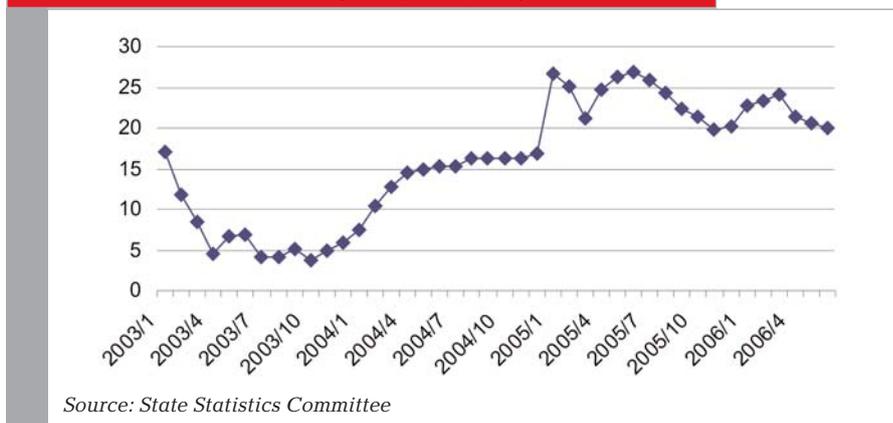
Building Growth in 1Q06 (% to 1Q05)



Convertible Building Bonds as Source of Investments (UAH, bln)



Real disposable income (% to prev. year)

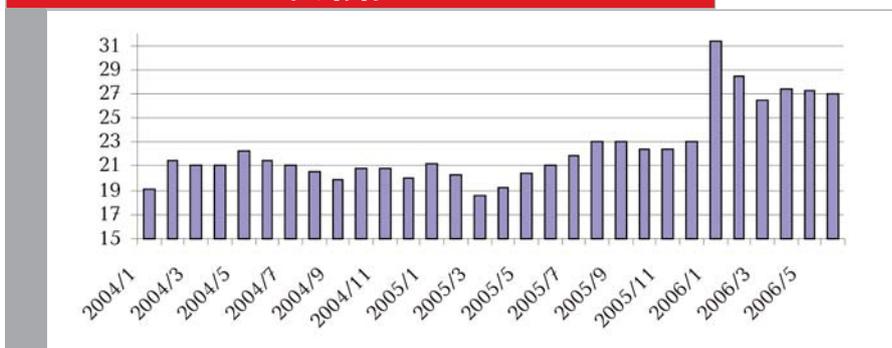


Retail Sales

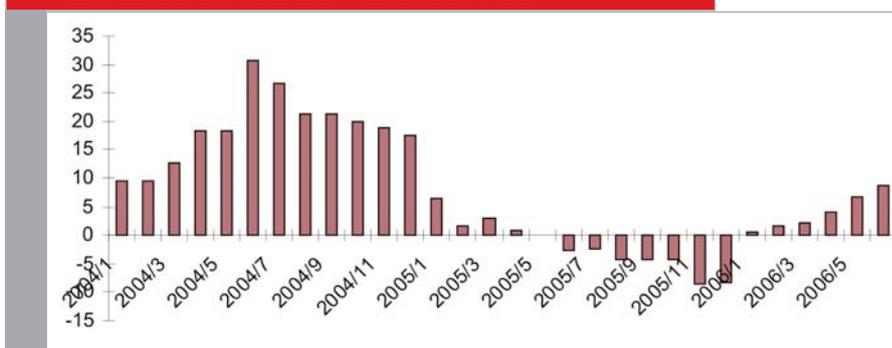
Retail sales growth remained rather high, although it decelerated to 27%. Both low deposits growth and growth in real disposable income continued to boost consumer demand. Retail sales for 2Q2006 totaled UAH 29.5 (USD 5,84 mln) as compared to UAH 24.2 bln in 1Q2006.

In the meanwhile, value added in wholesale and retail sector continued to grow on cumulative basis, which resulted from high consumer demand since the beginning of year. However, financial result in the companies of this sector proved to be twice as low as in the same period of 2005. We attribute such a decline to excessive expansion of this sector companies through bonds' issues and spending a lot on building the new trading areas.

Retail Sales Growth (% , y/y)



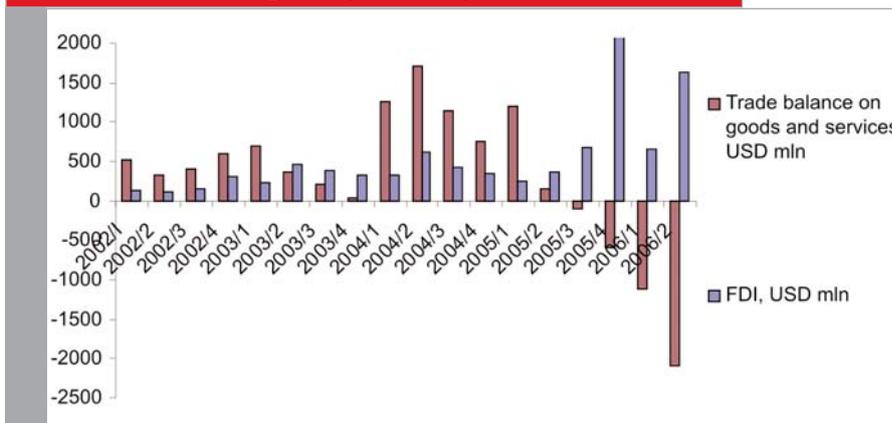
Value added in retail and wholesale trade



Current Account

Preliminary NBU current account data have shown the deficit of USD 0,9 bln, or 2,1% of GDP, which implies the decline of USD 3,1 bln during the last year. It resulted mainly from negative export dynamics, which changed for positive only in May and June, with +10,6% and +16,4% respectively. Leaders of growth in exports were machine-building, agriculture and chemicals, which are likely to continue to grow in 2H2006, due to high foreign demand. The robust growth has been registered in foreign direct investments, which were up 300% as compared to 1H2005 and amounted to USD 2 bln. The growth in the latter was mainly the result of a few M&A deals in banking sector, which is likely to decelerate in the further quarters.

Current Account Figures (USD, mln)



Our earlier assumption on exit of non-residents from OVDP has been confirmed: for 6M2006 net sales/redemption of state hryvnya-denominated securities in amount of USD 419 mln was registered (while their net purchase for 6M2006 amounted to USD 962 mln). It is noteworthy, that OVDP trading on secondary market has been espe-

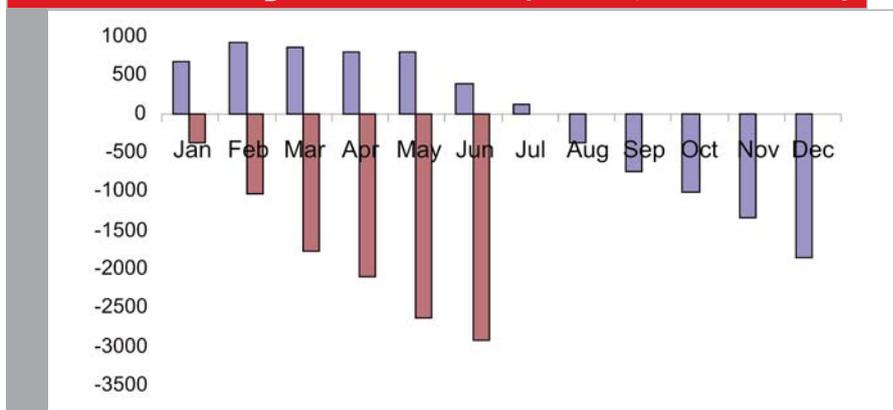
cially active in June. That month USD 109 mln worth of bonds were sold back by non-residents. During that month exports amounted to USD 3,2 bln, stemming from its growth from last the year figure of 16,2%, while imports continued to exceed exports; NBU interventions were positive standing at USD 247,3 mln, which is likely to stem from above-mentioned increase in FDI.

One of the most important competitiveness indicators, real effective exchange rate, devalued 4,6% for 1H2006. Its devaluation stemmed from the higher inflation in countries - main trading partners, as compared to Ukraine, and nominal devaluation of hryvnya to the main trading partners.

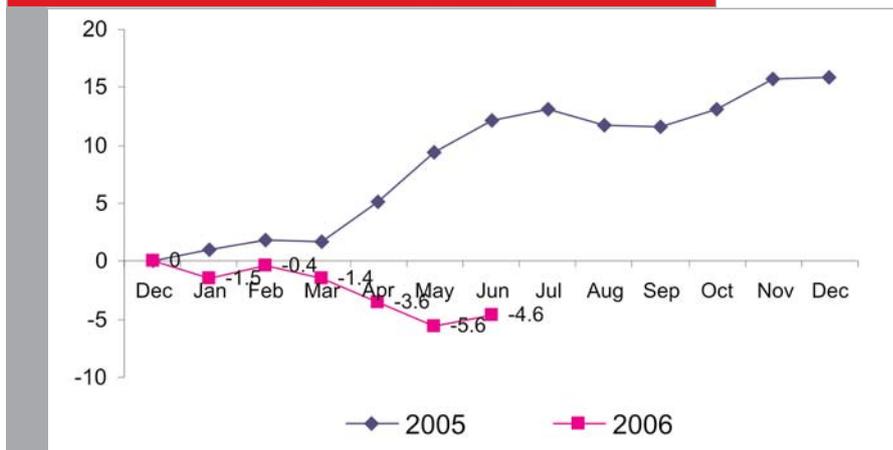
We expected REER YTD devaluation to improve competitive positions of Ukraine in the mid-term. In fact, with account of its lagged impact on trade balance, as opposite to 2005 15,9% revaluation, 4,6% devaluation registered in 1H2006 (and which is likely to proceed by the year-end) has brought YTD export decline to positive 2,2% and import growth to 22% for 6M2006 from negative import growth in the early 2006.

We forecast the improvement in current account later in 2H2006 resulting from faster export dynamics, further growth in FDI (but opposite to 1H2006, mainly due to machine-building investments, when Luganskteplovoy privatization is expected to proceed and banking, where a few other deals are expected). Finally, the competitiveness of domestic products is expected to grow as a result of both real effective exchange rate appreciation (see previous issue) and no further import tariff implementation (we exclude the possibility of Ukraine joining WTO in 2006). The current account figure is likely to reach the deficit of 0.9% of GDP based on results of 2006.

Trade Balance on goods in 2005-2006 (USD mln, YTD cumulative)



Real Effective Exchange Rate (% , YTD)



Note: calculated as changes in nominal hryvnya rate to the basket of currencies (occupying some 85% in the foreign trade), weighed for relevant inflation differentials

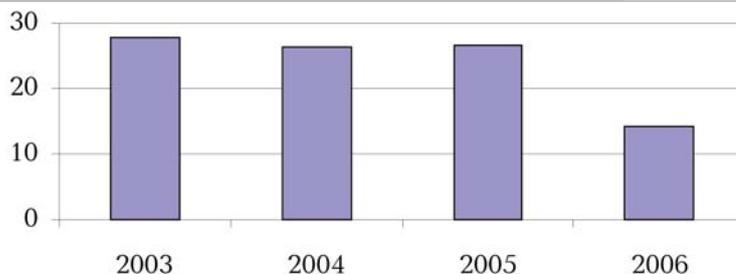
Monetary Developments

Slow capital inflows from abroad, lower demand for money combined with lack of incentives of individuals to save in hryvnya and continuing accumulation of other currencies assets, resulted in substantial slowdown of money growth.

Broad money growth has been almost twice as low as in the similar periods of preceding years, up 14% YTD. Base money has even dropped 0.7%, mainly under the impact of decline in banking reserves, bringing the volumes of extra liquidity down almost twice since January. Reserve requirements have been softened for the banks only in early August, which pushed the demand of banks for bonds to grow further.

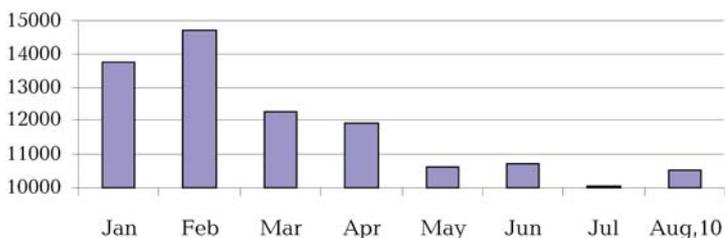
We do not see the reasons to revise our forecast of 25-28% money growth in 2006.

Broad Money YTD Growth (for Jan-July)



Source: National bank of Ukraine, VABank calculations

Money on bank's correspondent accounts in 2006 (UAH, mln; end-of-month)



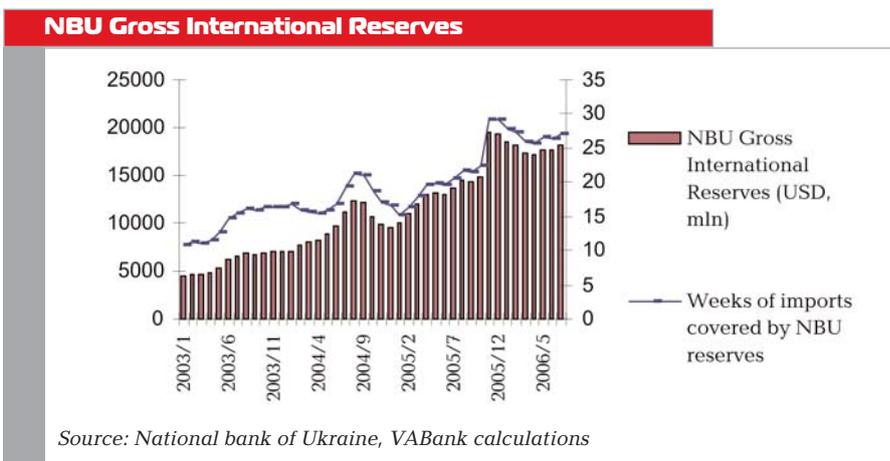
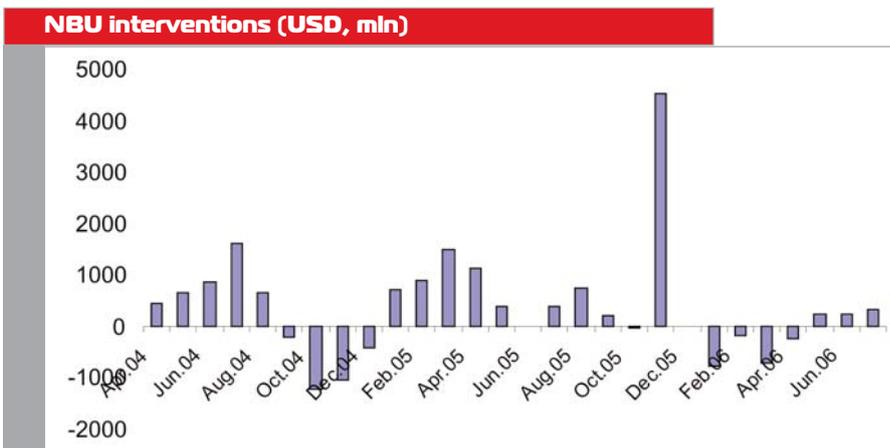
Exchange rate

Our expectations on unchanged level of exchange rate at 5.05 proved to be justified for the second quarter as well, as NBU's net interventions reverted to positive value in May and continued in June and July. After USD 1.6 bln have been sold from the international reserves for 4M2006, NBU increased its reserves up to USD 18,1 bln and coverage of imports by exports grew to 27.1 weeks as for mid-August.

We retain thus our forecast of official exchange rate in 2006 at unchanging level of 5,05 due to the following factors:

- decline in exports has almost finished as world steel demand is increasing
- reversal in trend of OVDPs sales by non-residents in 1H2006 to increased demand after Parliamentary unification and higher influx of foreign funds to the stock market, which will stimulate capital inflow

- as opposite to the March 2005 NBU's revaluation, when political pressure was more concentrated (import lobby), current coalition almost excludes the possibility of direct political interference in NBU policy
- USD current weakness, which makes hryvnya devalue to other trading partners, thus devaluing REER
- Expected shift of consumption to private savings. The latter will bring about the bulk of previously purchased currency to be either sold back or deposited to the banks (which is less likely under current USD devaluation), which will increase NBU's reserves further



Banking system outlook

Rate of lending growth to the individuals, exceeding that to the corporate sector 2,5 times since 2005, has affected the long end of yield curve. Banks still badly need long-term funds, which is expected to increase syndicated loans and Eurobonds issues, especially in late 2006 as political risks will diminish.

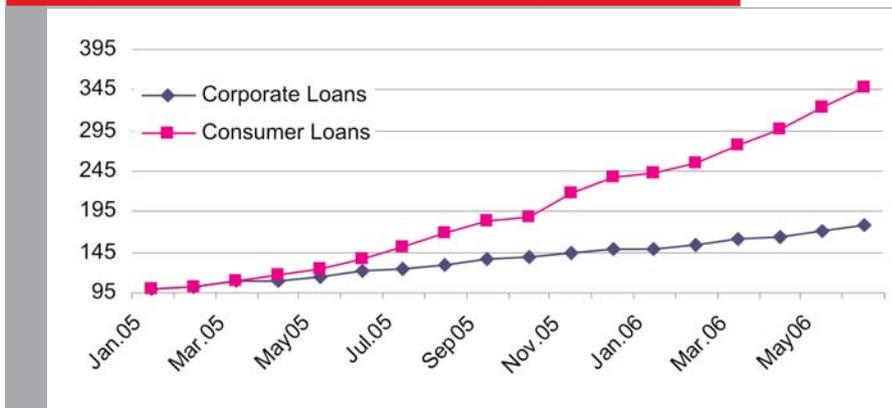
Long-term loans' share in lending portfolio has slightly increased in 1H2006. Long-term loans grew 29,86% for 1H2006 and their share in bank's lending portfolio reached 56,25%.

Banks' shareholders equity

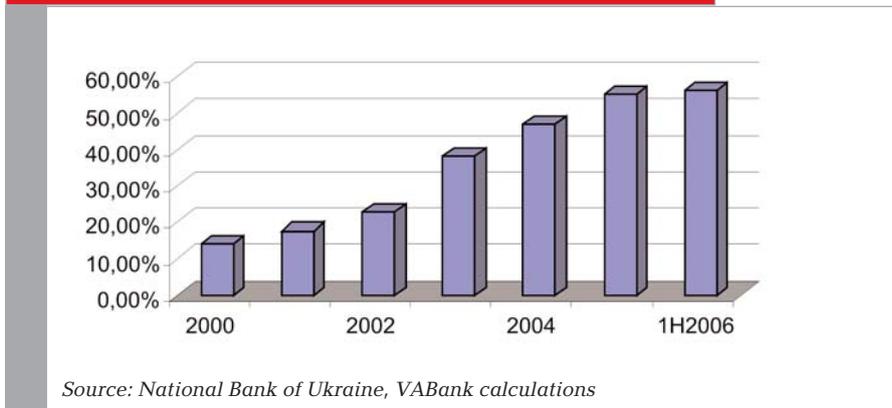
Based on results of 1H2006, rate of growth in the shareholders' equity (+6,34% YTD) was insignificantly lower than the rate of growth in banks' net assets (8,83%).

Capital adequacy ratio as for 01.07.2006 showed further decline and reached the lowest value since 2001 making 14,31%, which may be attributed to low growth in banks' equity. However, it remains much higher than NBU required value of 10%.

Corporate and Consumer Loans Growth (Jan.2005=100)



Long-term loans as % of loan portfolio



Net Assets and Bank's Equity (% Y/Y chg.)



Customer deposits

Individuals' anxiety after the elections has diminished and confidence of individuals to deposits in hryvnya grew again, as no obvious preconditions for hryvnya devaluation were confirmed. The difference between rates of growth in private hryvnya and currency deposits in June 2006 narrowed to 10,03%, as opposed to 15,59% in March 2005.

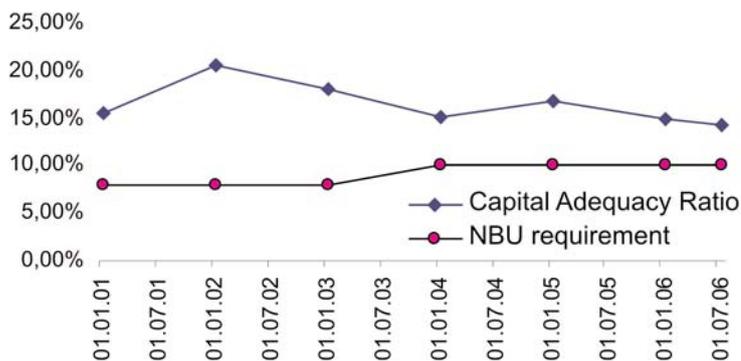
Bank assets

For the 1H2006 banks assets were up 18,80% and made UAH 264954 mln.

Assets grew due to increase of the banks loans by UAH 35840 mln (+24,89%) YTD. Loans to enterprises grew another +18,95% (UAH 20829 mln), private customer loans grew the most, +46.45% (UAH 15573 mln).

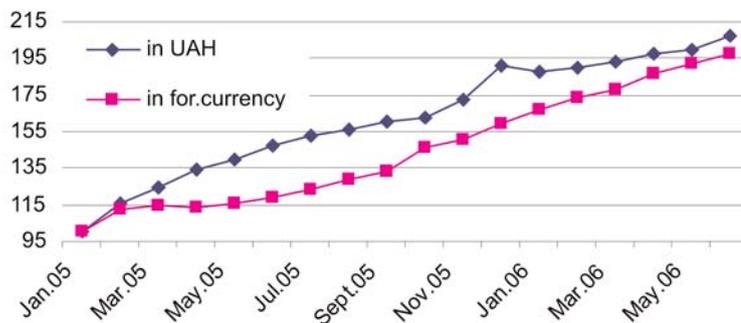
The structure of banks assets is the following: credit operations took 75,1% in structure of assets, high-liquid assets took 13,1%, investments in securities - 5,0%, fixed assets and intangible assets - 4,7%, accrued income - 0,9%, accounts receivable 0,8%, other assets - 0,4%.

Capital Adequacy Ratio Fulfillment



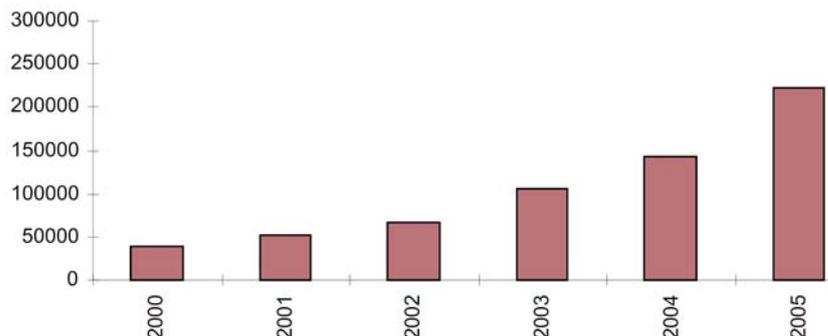
Source: National bank of Ukraine

Private deposits growth (Jan.2005=100)



Source: National bank of Ukraine, VABank calculations

Banks Assets (UAH, thous.)



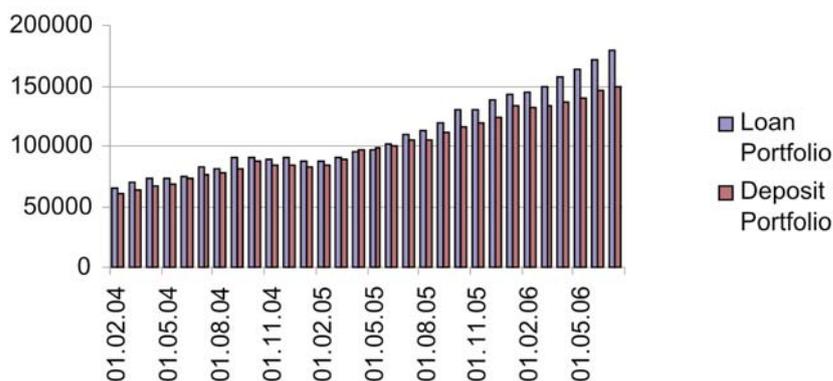
Lending portfolio of the banks

The loan portfolio continued growing at faster rate than deposit portfolio, exceeding the latter by 20,82%, or UAH 30991 mln.

Since the beginning of 2006, share of retail loans in bank loan portfolio has been growing steadily. Share of retail loans in bank loan portfolio exceeded 27,30% in June (in March 24,71%).

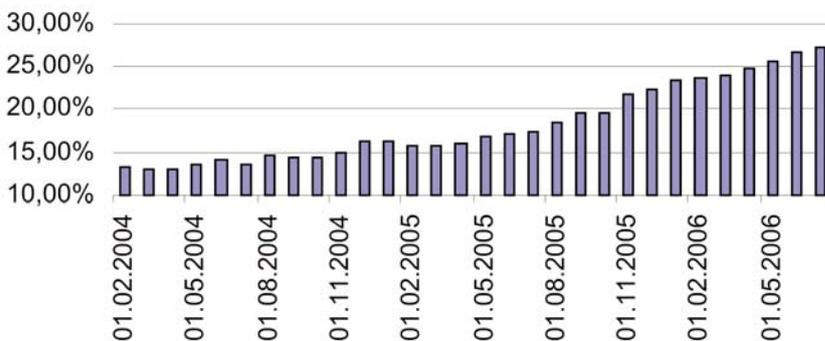
Share of non-performing loans continued to decline further, standing at only 2,32%, which is the lowest level registered so far.

Banks' Deposits and Loans (UAH, thous.)



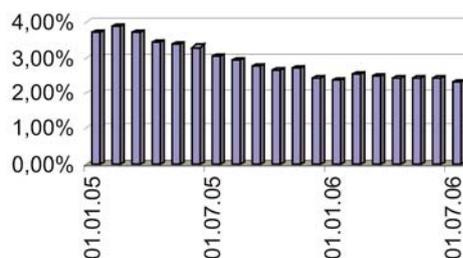
Source: National bank of Ukraine

Retail Loans in Total Banking Loan Portfolio



Source: National bank of Ukraine, VABank calculations

Share of NPL in Total Loan Portfolio



Source: National Bank of Ukraine

Bank incomes

Growing loan portfolio in a larger extent focusing on retail loans continued to improve the indicators of banks' profitability. Return on equity was up to 13,56%, which is 3,17% higher than as for beginning of year. Return on assets is by 0,31% higher than as for beginning of year.

In the meanwhile, net interest margin remains almost on unchanged level of 5%.

Interest Rates

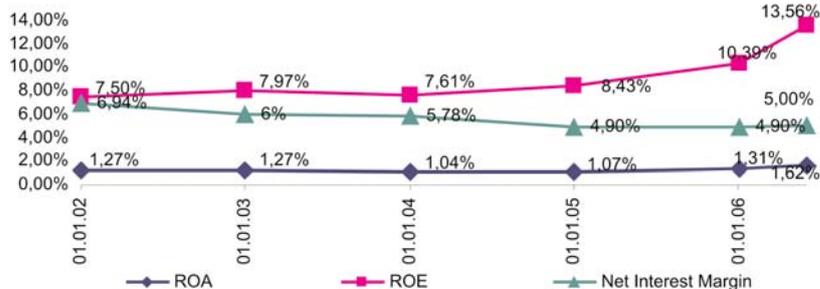
Slow growth in broad money and decline in base money has kept the rates from decline.

It is noteworthy, that the short end in hryvnya yield curve has dropped more (-20 bp, YTD) than its short end (-13 bp, YTD)

Dollar rates remained in general unchanged over the last quarter, as demand for retail loans remained high and even accelerated. The supply of dollar resources was also high, but the rates were restrained from decline by shortage of long-term USD deposits.

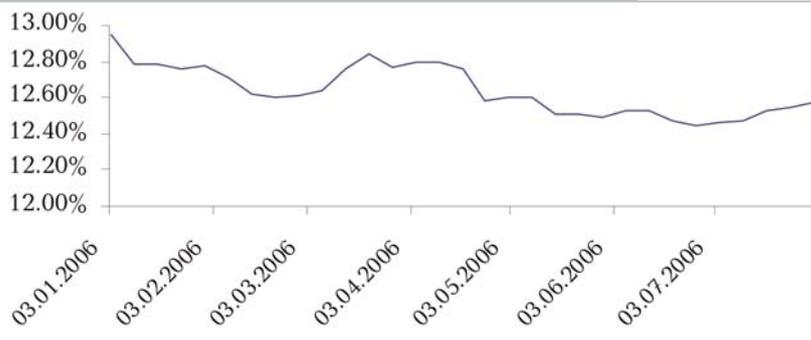
We expect the rates to be lower in late 3Q06 and 4Q06, as accumulation of foreign currency cash by the individuals (See Exchange rates), accompanied by planned growth in syndicated borrowings and bonds' issuance are likely to bring about the further growth of currency deposits in banks.

Main Banking Profitability Indicators



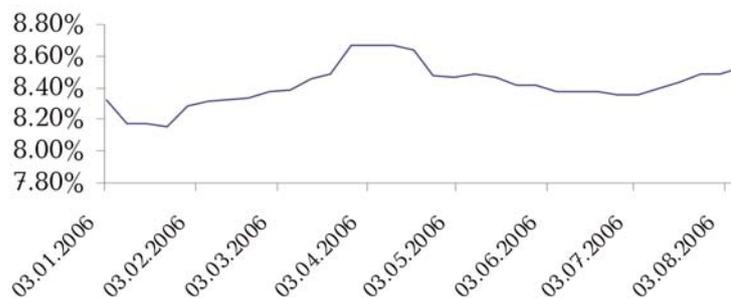
Source: National Bank of Ukraine

VABank UAH Depo Rates in 2006



Note: average yield curve for corporate deposit rates for the volume of deposit over UAH 100 thousand was taken into calculation

VABank USD Depo Rates in 2006



Note: average yield curve for corporate deposit rates for the volume of deposit over USD 50 thousand was taken into calculation

See VABank Weekly Market Analysis for more detailed interest rates analysis, monitoring and forecast.

Bond Market Outlook

Herewith we outline the main steps and peculiarities of investing into Ukrainian bonds

For investing in Ukrainian bonds a foreign investor needs:

- open the accounts in foreign currency and in national currency (hryvnya) in one of Ukrainian banks-residents;*
- sign the contract on broker service with a commercial bank or with a financial company, which have the State Commission for Securities and Stock Market of Ukraine license on providing broker services;*
- open the securities' accounts in a commercial bank, or in a financial company, which have the State Commission for Securities and Stock Market of Ukraine license on provision of depositary services.*

The foreign investor profits, received from investing in Ukrainian bonds, are subject to 15% taxation. Thus, an issuer, or person authorized by an issuer on payment agent functions on bonds retains tax from the profit of bond holder and transfers it to the Ukrainian State Budget. In case when investor's trading profit at bonds' buy-sale operations takes place, the investor's authorized broker has to retain tax from trade profit and transfer it to Ukrainian state budget.

In case if the foreign investor is the resident of country, with which Ukraine has a contract of double taxation avoidance, the investor's profits are subject to taxation rate, specified in the contract.

Cashless currency purchase operation in Ukraine bears additional expenses for the foreign investor - the buyer must pay 1.5% from the amount in hryvnya, at purchase of the foreign currency to the State Pension Fund.

Thus, foreign investor while investing to Ukrainian market is burdened both with transaction costs (payment of broker services, bank, custodian of securities and other intermediation) and tax payment at the foreign currency purchase.

Signed Agreements of Ukraine on Avoidance of Double Taxation

Country	Pact effective date	Repatriation	Tax (%)
Austria	20.05.99	2 ⁽¹⁾	5 ⁽²⁾
Azerbaijan	03.07.00		10
Algeria	01.07.04		10
Belgium	25.02.99	2 ⁽¹⁾	5 ⁽²⁾
Byelorussia	30.01.95		10
Bulgaria	03.10.97		10
Great Britain	11.08.93		0
Vietnam	19.11.96		10
Armenia	19.11.96		10
Greece	26.09.03		10
Georgia	01.04.99		10
Denmark	21.08.96		10
Egypt	27.02.02		12
Estonia	24.12.96		10
India	31.10.01		10
Indonesia	09.11.98		10
Iran	21.07.01		10
Italy	25.02.03		10
Kazakhstan	14.04.97		10
Canada	22.08.96		10
Kyrgyzstan	01.05.99		10
China	18.10.96		10
Republic Korea	19.03.02		5
Latvia	21.11.96		10
Liven	06.09.03		10
Lithuania	25.12.97		10
Macedonia	23.11.98		10
Moldova	27.05.96		10
Netherlands	02.11.96	2 ⁽¹⁾	10 ⁽²⁾
Norway	18.09.96		10
United Arab Emirates	09.03.04		3
Poland	24.03.94		10
Portugal	11.03.02		10
Russian Federation	03.08.99		10
Romania	17.11.97		10
Syria	04.05.04		10
Slovakia	22.11.96		10
USA	05.06.00		0
Tajikistan	01.06.03		10
Thailand	24.11.04	10 ⁽¹⁾	15 ⁽²⁾
Turkey	29.04.98		10
Turkmenistan	21.10.99		10
Hungary	24.06.96		10
Uzbekistan	25.07.95		10
Finland	14.02.98	5 ⁽¹⁾	10 ⁽²⁾
France	01.11.99	2 ⁽¹⁾	10 ⁽²⁾
Germany	04.10.96	2	5
Croatia	01.06.99		10
Czech	20.04.99		5
Switzerland	26.02.02	0 ⁽¹⁾	10 ⁽²⁾
Sweden	04.06.96		10

(1) - tax rate for banks and other financial companies; (2) - tax rate for all other persons

Main developments

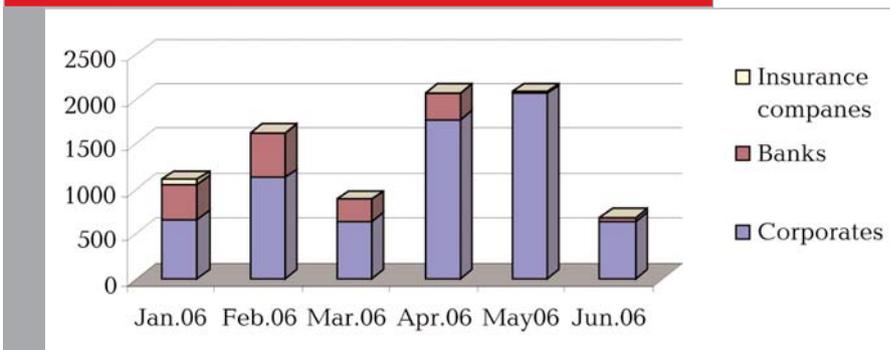
As much as UAH 2.29 bln worth of corporate bonds were issued for 2Q2006.

Lion's share of those issues fell on building companies (51,82%) and retailers (UAH 210 mln), banks occupied UAH 300 mln.

OVDP trading amounted to UAH 6.17 bln since the beginning of year, occupying the largest share in the total bonds' trading.

Since the beginning of 2006 the State Commission for Securities and Stock Market of Ukraine registered bonds issues on UAH 8.45 bln.

Domestic Hryvnya-denominated Bonds Issuance in 1H2006 (UAH, mln)

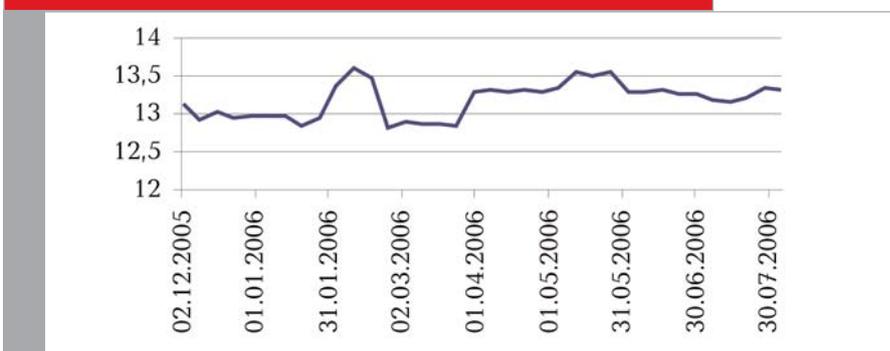


Bank Bonds

Interest rates on the banks' and financial companies bonds amounted on average to 13,3% (according to VABank Financial Bonds Index which includes average-weighted rate for 13 banks and 3 companies of financial sector).

Since the beginning of 2Q2006 the issues of bonds by only one bank in the amount of UAH 200 mln were registered: bonds of Ukrsofsbank (with 10% yield)

VABank Financial Bonds Index



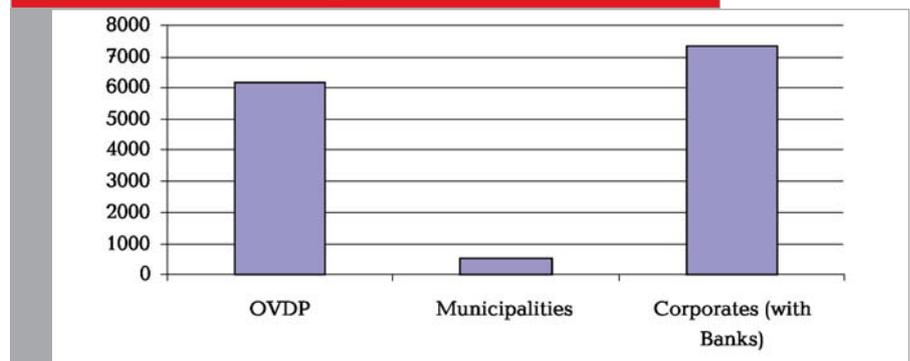
Issues of hryvnya bonds by banks in 2Q2006

Bank	Volume issued	Coupon yield %
Ukrsofsbank	200	10%

Secondary Market Trading

Trading activity has substantially increased in 2Q06, which was caused mainly by growing necessities of banks for managing liquidity at its supply remaining at sufficient level for banks. State bonds' trading has also been high, which stemmed from the opportunities to get short-term yield on those securities on the level exceeding average yield in the corporate segment. Another factor was revision of yields by many issuers upwards. In addition, in late July NBU has published the list of corporate bonds, which can be used as collateral for the banks' refinancing.

Volume of bonds trading on PFTS (1H2006, UAH mln)



As for municipalities' bonds, the demand in general did not match supply due to lower rates.

Eurobonds

Since the beginning of 2Q2006 the issues of Eurobonds weren't registered. Currently, the following bonds are circulating on market.

Issuer	Volume of issue (mln UAH)	Redemption	Coupon
AZOVSTAL, 2011 (LPN)	175 000 000/USD	28.02.2011	9.125%
Nadra Bank, 2008 (LPN)	100 000 000/USD	04.11.2008	9.5%
Aval Bank, 2007 (CLN)	100 000 000/USD	23.05.2007	-
ISD, 2010 (LPN)	150 000 000/USD	23.09.2010	9.25%
Kiev, 2008 (LPN)	150 000 000/USD	08.08.2008	8.75%
Kiev, 2011 (LPN)	200 000 000/USD	15.07.2011	8.625%
Kiev, 2015 (LPN)	250 000 000/USD	06.11.2015	8.00%
Kievstar GSM, 2009 (LPN)	266 420 000/USD	17.08.2009	10.375%
Kievstar GSM, 2012 (LPN)	175 000 000/USD	15.04.2012	7.75%
Naftogaz, 2009 (LPN)	500 000 000/USD	30.09.2009	8.125%
Privatbank, 2006 (LPN)	100 000 000/USD	19.12.2006	10.875%
Privatbank, 2016 (LPN)	150 000 000/USD	09.02.2016	8.75%
Stirol, 2008 (LPN)	125 000 000/USD	19.08.2008	7.875%
Ukraine, Ukr USD '07	1 129 329 000/USD	15.03.2007	11.00%
Ukraine, Ukr USD '09 (FRN)	500 000 000/USD	05.08.2009	6m LIBOR + 3.375%
Ukraine, Ukr USD '11	600 000 000/USD	04.03.2011	6.875%
Ukraine, Ukr USD '13	1 000 000 000/USD	11.06.2013	7.65%
Ukraine, Ukr Euro '07	1 133 331 000/EURO	15.03.2007	10.00%
Ukraine, Ukr Euro '15	600 000 000/EURO	13.10.2015	4.95%
UkrSibbank, 2007 (LPN)	100 000 000/USD	05.04.2007	10.5%
UkrSibbank, 2008 (LPN)	125 000 000/USD	14.07.2008	8.95%
Ukrsotsbank2008 (LPN)	100 000 000/USD	06.06.2008	9.00%
Ukrexmbank, 2009 (LPN)	250 000 000/USD	23.09.2009	7.75%
Ukrexmbank, 2012	250 000 000/USD	04.10.2012	6.8%
Ukrexmbank, 2016 (LPN)	95 000 000/USD	09.02.2016	8.4%
Yuzhmash, 2009	107 500 000/USD	21.01.2009	8.00%

Equity Market

Secondary Market Framework

Currently, PFTS (Stock Trading System) is almost a monopoly of securities' secondary market trading in Ukraine. It has been in operation since 1996 and currently is the largest marketplace and self-regulatory organization in Ukraine's stock and bond market.

The combination within the PFTS of computer and telecommunications technologies with the modern methods of execution the securities market' transactions has created in the past years an environment conducive to the stock market participants' civilized operation and to encouragement of local and international investors.

The operation of PFTS is supported by PFTS Technical Center, which holds Trading and Information System (TIS) License #1, granted by the Ukrainian State Securities and Stock Market Commission (SSMSC). PFTS uses hardware and software, which allows security brokers to trade in securities inter-regionally from their offices; in on-line mode through leased communications lines.

PFTS Association is self-regulatory organization (SRO) according to decision of the Ukrainian State Securities and Stock Market Commission. Only PFTS Association members are allowed to perform transactions at the PFTS trading system. All of them must comply with both Ukraine's stock market legislation and Association bylaws and rules. It means that in addition to state regulation, PFTS members (nearly a quarter of all companies and banks eligible for securities' trading) have agreed to assume additional obligations which would guarantee a fair market practice (that is to follow regulations and rules which are developed and implemented by market players).

Stock Market Developments in 2Q2006

During the second quarter, the equity market was dominated by strong price decline in May and June. On 12th of May, the PFTS Index reached its all-time high at 464,81 points. One month later on 15th of June, the PFTS Index dropped to 374,27 points or -19,5% bellow the all-time high. But over the complete second quarter, PFTS decreased from 426,27 to 380,24 points or "only" by 10,2%. The market liquidity, measured by the number of traded securities, increased slightly by 7%, but during May the market liquidity was extremely low.

Since June the dominating Ukrainian trading platform, the First Securities Trading System PFTS, has official status of a securities exchange - before it had only the status of an off-exchange trading platform.

An important topic during the second quarter has been the rights of minority shareholders: There have been two major conflicts between the minority and the majority shareholders of two blue chips - Zaporizhstal and Azovstal. Both companies did finance an acquisition of associated trading houses with a diluting share issue. Azovstal's shares have been traded at UAH 2,50 before the issue and afterwards around UAH 1,80 or 28% lower. Zaporizhstal shares have been traded at UAH 6,50 before the issue and afterwards around UAH 3,00 or 58% lower. Minority shareholders have been offered the option of selling their stakes to the owner, but the repurchase price did not cover the minority shareholders' losses from the unexpected issues. Zaporizhstal offers to buy back its shares for UAH 1,87 (or 71% lower) and Azovstal offers to buy back its shares for UAH 1,80 (or 28% lower). The PFTS decided to suspend the shares of Zaporizhstal from the trading and to take the shares out of the PFTS Index calculation. Additionally, minority shareholders, represented by several Ukrainian investments banks, decided to sue for damages at the Kiev economic court.

Other major topics have been the postponement of the Ukrtelecom privatization, the announcement of the auction of the 76% state stake of Luganskteplovov to be hold in September. And of course, the Ukrainian equity market suffered significantly under the political instability caused by the long-winded building process of a new government after the parliamentary elections in March.

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