

CONTENTS

Shock & Awe: Gazprom Caves

A Victory for Tymoshenko

Real Sector Revives

Prices, Monetary Policy and Financial Markets

A Crackdown on Smuggling

Trade Deficit Widening

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A Coup for Tymoshenko

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EXECUTIVE SUMMARY

Gazprom's stunning retreat from its insistence upon maintaining a gas market intermediary in Ukraine has left both Ukrainians and Russians buzzing about its significance. Some analysts believe Gazprom made a strategic retreat, while others are crediting the government of Prime Minister Yulia Tymoshenko with an extraordinary victory. The deal, announced March 12, has psychological and historical importance for the Ukrainian establishment: it's the first time in history that the Russian gas monopoly has backed off on its demands. The development was so unexpected that some analysts are still hesitant to draw conclusions. But whoever ends up benefitting, it's clear this is a first for the Ukrainian gas market.

If the deal is actually signed – both governments still need to ratify the pact – Tymoshenko will reap huge political dividends at home, for “defeating Gazprom,” and for her ability to keep public service energy prices basically stable. But industry should be prepared to pay the promised hike to \$320 per 1000 m3 in 2009, and also for an increase in retail gas prices, even this year.

Tymoshenko isn't finished: she's already taking steps to execute the agreement. On March 19th, her government proposed several significant changes to restrict Gazprom's activities in Ukraine, and to curtail the participation RosUkrEnergo, an intermediary in which Gazprom participates. The next day, the government banned RosUkrEnergo from exporting any gas from Ukraine. These steps are likely to produce another wave of confrontation.

The economy continues to be robust. The real sector began recovering in February, after weak January performance. Growth for the first two months of the year sped up to 5.8%, from 4.9% in January. Favorable foreign market opportunities and high internal demand continue to be the main driving forces of growth. But inflation is running even faster than our pessimistic projections, with CPI reaching nearly 22% y/y.