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GlobalSOURCE
641 Lexington Avenue
18th Floor
New York, NY 10022
Phone: 212-317-8015

info@globalsourcepartners.com
www.globalsourcepartners.com

All About Politics

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Dmytro Boyarchuk, Viktor Skarshevsky & Vladimir Dubrovskiy

EXECUTIVE SUMMARY

In recent months, Ukraine made taken more steps on the thorny path to mature democracy. The seemingly permanent confrontation between Prime Minister Yulia Tymoshenko and President Viktor Yushchenko is speeding up the process, although it is stormy. In May the political process took what may provisionally be seen as positive steps on social issues.

The biggest scandal was related to Vanco, the company that was awarded a long-term license to develop the Black Sea shelf and was expected to make a large investment in the oil extraction project. However, the licensing exercise was rather dubious, and no investments have been seen. The Ukrainian government had complained about the company before, but only Tymoshenko dared to inform the public and cancel the contract.

The political confrontation also reflected on the situation with the exchange rate policy. Although the central bank clearly realizes that a free-floating regime is the only reasonable option under current economic developments, the head of the National Bank of Ukraine is still undecided about how to shape the regime. Most likely different opinions from political forces are making him think long and carefully. Throughout May and the beginning of June, the central bank has been "simulating fluctuations" with microscopic changes to the official exchange rate for the hryvnia; however, *de facto* the regime is the same.

Meanwhile, inflation seems to be calming down on the heels of the seasonal decrease in food prices. In May, the CPI slowed down to 1.3% m/m; however, in year-on-year terms, the dynamics are impressive: 31.1%. Tightened monetary policy also contributed somewhat to the positive changes. The credit volumes decelerated drastically (+1.0% m/m) in May, but they still keep growing.

Although budget implementation has been proceeding successfully so far, the Ministry of Finance is likely to have problems with deficit financing. Initially, money was expected from privatization; however, the mess with the replacement of the head of the State Property Fund led the government to think about Eurobonds placement.