GlobalSOURCE UKRAINE QUARTERLY OUTLOOK

CONTENTS

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

info@globalsourcepartners.com
www.globalsourcepartners.com

Ukraine Forecast

Inflation Spoils the Party

June 5, 2008
Dmytro Boyarchuk, Viktor Skarshevsky & Volodymyr Dubrovsky

EXECUTIVE SUMMARY

Much of Ukraine's galloping CPI – now running at over 30% – was driven by global price trends. But domestic fiscal and monetary policy, and overheated demand, likewise bore heavily responsibility. The NBU raised interest rates, and also took several other tightening measures: it stopped buying dollars on the interbank market and pulled back on pumping hryvnia into the economy. So shortages of local currency quickly appeared, and banks reported liquidity problems. Overnight lending rates promptly climbed, and have been running in the 15%-30% range.

The FX market has also been in turmoil. The abandonment of dollar purchase operations brought in a de facto free-floating exchange regime, undoing the 5.05 hryvnia to the U.S. dollar fixed exchange the government had long supported. Although regulators kept buying Euros and GBP, hryvnia rates for other currencies, defined by US dollar rates, likewise began fluctuating freely. When the hryvnia appreciated to 4.5 to the dollar, on the back of significant investment inflow, the Central Bank started intervening again. This left the exchange rate at 4.7-4.8 to the dollar, and the official rate at 4.85. We believe this will be the new benchmark for the near future -- but over the longer term, we see devaluation pressure.

The current account deficit is ballooning; provisional Q1 results put it at 9.4% of GDP. Booming private consumption, investment demand and permanently higher energy prices are to blame, but hryvnia revaluation has aggravated the situation. We expect the deficit to rise to 7.4% of GDP this year, then to soar as high as 10% in 2009.

We've also lowered our 2008 GDP growth forecast, to 5.8% from 6.5%, and to 5.5% from 6.4% in 2009, as banks' liquidity problems and rising interest rates likely to slow private consumption.