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### Investment Risks Higher After Russia's Attack on Georgia

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## EXECUTIVE SUMMARY

The Russia-Georgia war has increased investment risks for Ukraine, as Russia has acted on its longstanding desire to increase its influence over the CIS region. Ukraine is considered one of the possible candidates for "peace enforcement." We don't expect military conflict between Ukraine and Russia in the near future, but believe Ukraine will face repercussions for the hard line President Viktor Yushchenko took against Russia's invasion of South Osetia in August. This will be felt, first, in negative developments in trade and energy: Ukraine is likely to be forced to pay double for natural gas from Russia starting in 2009. We've lowered our 2009 GDP growth forecast to 5.1%, from 5.5%.

But we're sticking with our 2008 GDP growth forecast of 6.4%. Expected record high grain export volumes should mitigate the rise of the current account deficit, to 6.1% of GDP, but we expect the deficit to soar to over 10% of GDP in 2009, due continued exceeding growth of imports over exports. Though the local hryvnia has recently revalued, we expect it to begin to devalue toward 5 to the dollar by yearend, and further down to 5.2 per \$1 in 2009.

Slight summer deflation induced us to shave our 2008 CPI forecast to 25.1%, from 26%. Favorable weather conditions helped subdue supply side inflation, while overheated demand persists. But consumer price growth is likely to resume in fall, with increasing utility tariffs, and the costs of implementing populist social policy.

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