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Much Hangs on Coalition Talks

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EXECUTIVE SUMMARY

The makeup of a new parliamentary coalition is still under discussion, though three weeks have passed since election of the new parliament. The split in the pro-president party Our Ukraine is the main source of the uncertainty. Several deputies want to form a so-called wide coalition with Party of Regions. Since the Orange majority is a razor-thin two votes, there's a chance that Yulia Tymoshenko may stay in the opposition.

Political uncertainty doesn't seem to be bothering investors, though. There were two more banking sector acquisitions in November. Sweden's SEB bank and Bank of Cyprus purchased medium-sized local banks. Several other purchase negotiations are in progress.

The fast-growing banking market pressed Ukrainian bankers and the EBRD to create a floating reference rate, the KievPrime. The new index is calculated daily by Reuters, based on offered inter-bank deposit rates in hryvnia. The new index is expected to enhance the transparency and efficiency of the Ukrainian money markets.

The real sector showed signs of recovery in October. GDP rose to 7% y/y on the back of manufacturing, transport and trade, though GDP was flat for the first time this year in y/y terms, at 7.3%. But agricultural output continued to fall, the result of a poor grain harvest.

By fall, consumer prices were rising at their fastest rate in seven years. CPI escalated to 11.2% YTD in October, and were up 14.8% y/y. Rising food prices were a driving force. Transportation tariffs also contributed, due to growing fuel costs.

The Central Bank continued to accumulate reserves, by intervening in the FX market. Gross reserves were \$31.7 billion by the end of October, equal to 5.4 months of imports.

Ukraine finally signed a long-awaited bilateral protocol with Kyrgyz Republic this month. The agreement completed WTO negotiations for Ukraine. The WTO's working group is expected to approve the final report on Ukraine's WTO accession in December.