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EXECUTIVE SUMMARY

President Victor Yushchenko's October 8th announcement that he would dissolve Parliament went against his own best interests, and arrived amid economic crisis. Failure of Parliament's two rival factions to establish a new coalition gave the president the upper hand. Though his initial goal has been to oust Prime Minister Yulia Tymoshenko, delaying elections would have been more to his advantage.

The metallurgy and chemicals industries have been sliding, along with world demand. The food-processing industry suffered from high input costs and shrinking internal demand. The main drivers of the real sector suddenly requested state support, with lower transportation tariffs and energy prices.

Naturally those problems in Ukraine's main exporting sectors led to rapid devaluation. The hryvnia fell by 8.5%, and was fluctuating around UAH 5.3 per \$1 at the beginning of October. The Central Bank characterized the changes as short-term panic, driven by non-resident speculators withdrawing their funds from Ukraine. But as soon as the Bank unsuccessfully tried to take control of the market, via significant intervention, it became obvious that devaluation had fundamental causes. The NBU is now likely to pursue a hands-off FX policy, with only minor interventions. If that's right, we can expect the hryvnia to reach UAH 6 per U.S. dollar by yearend, and to UAH 7.0 through 2009.

We also see disturbing signals in the banking sector >>>

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