



Teetering On the Brink

President Rescinds Decree Cancelling 7 December Election

President Viktor Yushchenko has cancelled his decree which dissolves parliament and calls for new elections on 7 December. The step enables parliament to pass vital budget legislation and measures aimed at alleviating the financial crisis threatening Ukraine's economy. At a press conference the president suggested that pre-term elections would be held on 14 December.



▲ Focusing minds on the financial crisis. On Sunday Ukraine's Prime Minister Yulia Tymoshenko addressed the nation on TV. A day later President Viktor Yushchenko rescinded his decree so that parliament can pass vital legislation.

The presidential decree was cancelled following a meeting of the National Security and Defence Council (NSDC) which met on Monday. "We hope that parliament will approve the anti-crisis measures which were discussed at the Security Council," said the president.

The president's announcement was aired on national TV. It follows Prime Minister Yulia Tymoshenko's TV address on Sunday, in which she appealed for the formation of a new coalition government to tackle the effects of the global financial crisis. A sombre premier told viewers that it would be "reckless" to hold elections given the severity of the threat facing the country.

Ms Tymoshenko suggested postponing the elections, originally scheduled for 7 December, in order that a reshuffled government, based on a broad coalition, could work on plans to stabilise the financial sector and strengthen the economy. "Such a coalition should act until such time as the threat of financial and economic collapse is removed from our country and the world at large. After that, you can have any elections you like."

On Monday the president made it clear that he thought the financial crisis was best handled by the NSDC and the premier's efforts to form a broad coalition were spurned.

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Mr Yushchenko hopes parliament will pass spending cuts and create a fund to help prop up ailing banks and companies. The president rescinded his decree at a time when Ukraine is finalising a loan from the International Monetary Fund (IMF) to shore up its creaking financial system. Last week the government confirmed that the IMF is willing to loan up to \$15 billion to help strengthen Ukraine's financial services sector.

Until recently the global financial crisis had not severely impacted Ukraine's economy, which is still expected to grow 6.9 percent this year. However, recent events have proven the 46 million



population former-Soviet republic is not immune to the global turmoil gripping the world's financial markets.

Central Bank Steps In

Recently, the National Bank of Ukraine (NBU) was forced prop up Prominvestbank, Ukraine's sixth largest bank, after anxious investors in the east of the country withdrew \$1.3 billion. It now looks likely Prominvestbank will be nationalised – a move that has received the premier's blessing. "We should return this bank back to the state and the state will assume all responsibility for Prominvestbank's obligations," said Ms Tymoshenko.

Also, a \$300 million loan has kept Nadra, the seventh-largest bank afloat. On Friday the NBU relaxed measures imposed on banks across the retail sector, which had included freezing selected accounts.

Associated Press reported Volodymyr Dinul, an analyst with Renaissance Capital, as saying: "It looks like the National Bank is in control of the situation. Let us hope that everything will calm down sooner rather than later."



Macroeconomic Warning Lights Flashing

Ukraine's macroeconomic indicators reveal that the economy is vulnerable. "It is the equivalent of warning lights flashing," said a London-based emerging markets analyst.

The government is still grappling with curbing inflation, which in May topped 31 percent before falling back to 16 percent in September, as anti-inflationary measures implemented by the Cabinet of Ministers bore fruit. Indeed, in July the country experienced 0.5 percent deflation.

But perhaps of more immediate concern is the pressure on the hryvnia which on Monday was at UAH 5.45 to the dollar. In recent weeks, the currency has taken a battering as investors exited emerging markets in a scramble for dollars. Nevertheless, the NBU has reserves of \$37.5 billion to prop up the currency but is concerned not to draw too heavily on its reserves.

Current Account Deficit Widens

At the same time the country's widening current account deficit is cause for alarm. This is being aggravated by the country's trade deficit, which, for the first eight months of the year, has grown to \$12.5 billion from \$5.9 billion in the same period last year. This has not been helped by a global drop in the demand for steel – one of Ukraine's principal exports.

According to SigmaBleyzer, in 2009 "the current account deficit is likely to widen to \$24 billion, which corresponds to 10 percent of forecasted GDP." Of this gap, about \$10 billion reflects the likely increase in the cost of imported gas.

However one London-based analyst thought these figures were somewhat gloomy. He told Inform that he considered the predicted \$24 billion figure was high as a slowing economy will see



▲ The Headquarters of the National Bank of Ukraine (NBU). Like many European national banks, the NBU has stepped in to save several banks from collapse. It is taking further precautionary measures, including arranging loan facilities with the IMF.



import demand fade and he anticipated some foreign exchange devaluation. He also suggested a slowing economy would see energy consumption fall and, together with energy conservation measures and a reasonable price for gas, the gap would be lower than predicted.



▲ Gas talks with Russian premier Vladimir Putin took place in Moscow on 2 October.

Recent gas negotiations between Prime Minister Tymoshenko and her Russian Federation counterpart, Vladimir Putin, resulted in a broad market agreement, which foresees a gradual increase to market prices over a three-year period. Although a final decision on the price is expected in November, Naftohaz Ukrainy CEO, Oleh Dubnya, has said he expects the 2009 gas price to be in the vicinity of \$250 to \$300 per 1,000 cubic meters.

High Credit Risk

Another cause for concern is Ukraine's relatively high level of external debt. In the last two years total external debt grew 45 percent to \$100 billion. Most of this is fuelled by the corporate and banking sectors, both of which are now under intense pressure. Ukraine's fledgling stock market has lost some 43 percent of its value in October alone, after gains last year of 130 percent.



The uncertainty surrounding the economy and financial sector has seen the country downgraded in terms of its ability to pay back debt. Ukraine is seen as a high default risk, with its Credit Default Swaps (an insurance-like contract that promises to cover losses on a bond in the event of default by the bond issuer) now trading at a mind-boggling 2,000 basis points.

This means that the annual cost of insuring \$10 million of debt for five years has rocketed. According to Markit, a credit research firm, such a price tag would involve "an upfront payment of over \$4 million plus \$500,000 a year."

This mounting risk is reflected in the US Treasury's Quarterly Assessment of Financial Risks, September 2008, which placed Ukraine among the 10 top financial risks in the world.

On Monday Moody's cut its sovereign rating outlook on Ukraine to stable from positive. On Friday, Fitch Ratings downgraded its long-term foreign and local currency issuer default rating on Ukraine to "B+" from "BB-". A statement from Fitch said: "The downgrade reflects Fitch's concern that the risk of a financial crisis in Ukraine involving a large depreciation of the currency, further stress in the banking system and significant damage to Ukraine's real economy is significant and rising."

IMF to the Rescue

Last week Ukraine joined Hungary, Iceland and Serbia by approaching the IMF for assistance. The head of the NBU, Petro Poroshenko stressed that IMF funds were only a contingency to "calm down investors."



Mr Poroshenko's First Deputy Chairman, Anatoly Shapovalov, said that the size of the credit from the IMF would depend on Ukraine's quota subscription in the fund. This is believed to be around \$2 billion. Normally countries draw three to five times the amount in the fund. But such a sizeable loan would come with many conditions attached.



"At the moment, we do not need these funds, but who can say how the global crisis will develop tomorrow?" said Mr Shapovalov.

The IMF has denied that the funding is contingent on the early elections being postponed. However, over the weekend the New York Times quoted BYUT lawmaker Sergei Teriokhin as saying that "if the contested status of the cabinet is not resolved, the monetary fund will not know whom to meet with."

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Election Madness

Given the financial and economic turmoil, most observers are aghast by the president's decision to dissolve parliament and hold an election – a process that could deprive the country of a government until spring 2009.

"It would be morally and politically irresponsible to hold elections at this time," said Ms Tymoshenko, "the world is facing its sternest financial crisis for a generation and we decide the best way to resolve it in Ukraine is to spend \$80 million on an election. As rational, responsible leaders we must act calmly and swiftly. The country needs stability, so I appeal once more for unity."

EPP Sends Message to the President

Last Tuesday Prime Minister Yulia Tymoshenko attended a meeting of the European People's Party (EPP) in Brussels. At a press conference, the President of the EPP, Wilfried Martens, called upon President Viktor Yushchenko to cancel his decision dissolving parliament, triggering early elections. A statement signed by EPP members reinforced the message to Ukraine's president.



▲ EEP President Wilfried Martens led his members in calling for President Viktor Yushchenko to cancel the dissolution of parliament and election slated for 7 December. The EPP supports an enlarged coalition of democratic forces.

"The EPP strongly supports the revival and strengthening of the coalition of democratic pro-European forces in Ukraine," said Mr Martens.

Mr Martens said that it was essential for Ukraine to have an effective and stable government in the face of the global financial crisis. He stressed that political stability is a key precondition for the successful European integration of Ukraine.

Both Ms Tymoshenko's Batkivshchyna party and President Viktor Yushchenko's People's Union Our Ukraine party are observer members of the EPP. Founded in 1976, the EPP is the family of Europe's centre-right parties. It is Europe's largest transnational political party with 74 member-parties from 38 countries – including 20 heads of government (13 EU and seven non-EU), nine European Commissioners (including the EU President) and the largest group in the European Parliament with 288 members.



In calling for the restoration of a democratic coalition, Mr Martens was at pains to underline that the EPP's appeal was not an attack on President Yushchenko. "We are asking him to cancel his decision on snap elections," he said.

Mr Martens said that a third election in as many years would undermine stability. "What Ukraine needs today is NOT new elections, but a responsible leadership and a stable government. Now is the time for unity, not for division.

"We express our full support for those leaders in Ukraine who are doing everything to stabilise the governmental coalition, those who continue with social market reforms."

The EPP leaders announced that its statement was signed by all summit participants – prime ministers and heads of European states.

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▲ Prime Minister Yulia Tymoshenko with the Prime Minister of Italy, Silvio Berlusconi.

During the EPP summit, Ms Tymoshenko held bilateral meetings with Polish Prime Minister Donald Tusk, Italian Prime Minister Silvio Berlusconi, and with French Prime Minister François Fillon.

Election Funding Approved

Despite being against another election, Ms Tymoshenko's government duly upheld the law and last week passed amendments to the 2008 national budget to allocate the necessary funding. A statement said that the Minister for Finance, Viktor Pynzenyk, formally complied with the order from the National Security and Defence Council, which insisted that monies for the election be allocated. A fund of 417 million hryvnia (\$80 million) was approved.

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▲ Viktor Pynzenyk, Minister for Finance.

"We will follow the law, but hope that good sense will prevail and the president will call off the election," said Mr Pynzenyk.

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Bloc of Yulia Tymoshenko