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# NEW EUROPE ECONOMICS & STRATEGY

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FOCUS NOTES: UKRAINE

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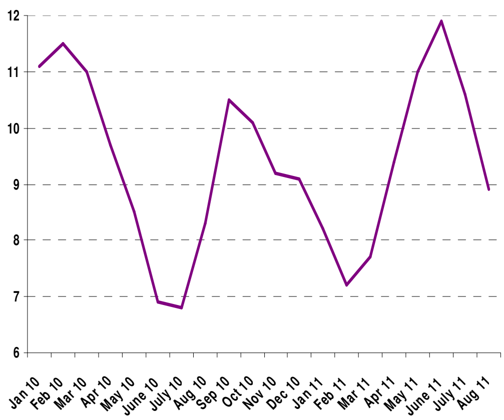
## IMF loan is still frozen with no urgent need for its resumption

- Inflation easing in recent months on robust grain harvest
- IMF loan is still frozen with no urgent need for its resumption; next IMF visit has been rescheduled for late October

**Inflation easing on robust grain harvest**

Ukraine's headline inflation slowed to 8.9% yoy in August. What's more, it declined by 0.4% mom for a second month in a row (from -1.3% mom recorded in July). The mom deceleration observed in the two previous months stems from food price decrease due to seasonal decline related to robust grain harvest. Furthermore, the yoy deceleration was widely expected due to base effects (since August 2010 CPI was elevated on 50% gas tariff hike). We expect inflation to slow further in September, but we see a pick-up towards the end of the year given a hike in domestic gas tariffs before year-end (which is a prerequisite condition for resumption of the IMF loan). Although, inflationary pressures were building up in 2011 on commodity price surge, the recent drop in food prices should contain part of the upward strain on inflation and hence we expect headline inflation to average at 9.8% yoy in 2011. (Figure 1)

**Figure 1**
**Inflationary pressure were building up in 2011 after having bottomed in 2010**




*Source: National Statistics, Eurobank Research*

**IMF loan is still frozen without any pressing need for its resumption**

In late August, Ukraine's Prime Minister, Nikolay Azarov, said that the country has no urgent need for financing from the IMF, which goes to the Central Bank's reserves, given favourable developments on the balance of payments; in July reserves amounted to $37.8bn from $34.6bn in 2010. However, the IMF lending programme on track is necessary to ensure favourable terms in external financing, taking into account that the government will need to borrow more by year-end to finance the budget deficit. Yet, Ukraine's authorities are balancing between the benefits of the IMF programme and the potential negative impact of IMF unpopular conditions on the ruling party's political prospects ahead of the October 2012 parliamentary elections.

The IMF's mission was due to return in late August but their visit has been rescheduled for late October in order to provide additional time to the government to push through reforms. In the meantime, in early September, the Ukrainian Parliament passed and the President signed the pension reform which envisages a gradual increase in the pension age for women to 60 and other long-term savings measures, coming into effect on October, 1. Although, this development is definitely positive, the IMF insists on Ukraine raising household gas rate before loan resumption. Moreover, cooperation also hinged on the 2012 state budget with the IMF asking for a deficit of 2.5% of GDP vs. 3.5% of GDP planned for 2011.

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