

UKRAINE

Warning: Correction Ahead

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Warning: correction ahead. Ukraine seems to be approaching a breaking point. The political climate in the runup to October 28th parliamentary elections promises to be tough, and may bring surprises. Brace for bumps.

Currency devaluation is the first risk. Even the Euro 2012 championship failed to bolster the *hryvnia*; the market is now expecting it to devalue. The forthcoming gas bill increase, coupled with impending IMF payments this autumn, are strengthening this sentiment. What's more, fiscal policy is becoming increasingly destructive. In addition to crowding out investments from the real sector (since banks are borrowing mainly from the government), the authorities continue extracting scarce funds from enterprises via administrative pressure. This might be good for the government balance sheet in the short-term, but companies are already reporting liquidity problems, amid high interest rates. Monetary policy is another problem. The Central Bank is obsessed with *hryvnia* stability, and is tamping down devaluation sentiments with a cash deficit. But this policy cuts both ways: the Bank might prevent a currency panic for awhile, but the real sector will only sink deeper into trouble. Given these conditions>>>