Inflation

Back to the twenties

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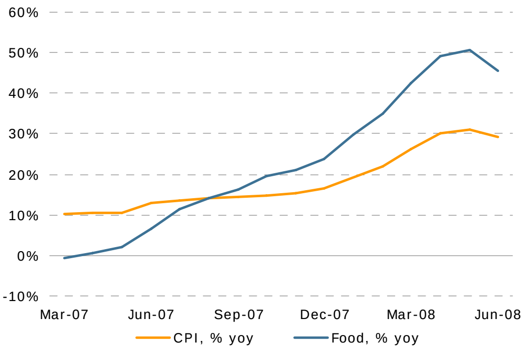
- **Today, the State Statistics Committee reported that CPI grew 29.3% yoy in June, down from 31.1% yoy in May**
- **Food prices showed obvious signs of subsiding, as prices for newly harvested fruits and vegetables, and dairy dipped**
- **Amendments to the 2008 state budget with inflation-adjusted revenues and expenses are set to be adopted this week**

CPI growth plunges back into the 20s



Source: State Statistics Committee

Key macroeconomic indicators

	2007	2008E	2009F
Real economy			
Real GDP, % yoy	7.6	6.8	6.5
Nominal GDP, USD bln	141.2	194.0	239.3
Industrial output, % yoy	10.2	8.7	7.5
CPI (eop), % yoy	16.6	21.0	15.0
PPI (eop), % yoy	23.2	33.0	18.0
Retail trade, % yoy	28.8	25.5	25.0
Banking assets, % yoy	76.0	50.0	45.0
Construction, % yoy	15.8	5.0	10.0
External sector			
Trade balance, % GDP	-5.6	-5.5	-5.8
Current account balance, % GDP	-4.2	-4.5	-5.3
Net FDI, USD bln	9.9	11.4	15.0
NBU reserves, USD bln	32.5	38.7	37.5
External debt, % GDP	59.9	58.8	58.8
Monetary & fiscal policy			
Money supply (M3), % yoy	51.7	25.0	40.0
Official UAH/USD (eop)	5.05	4.95	4.90
Consolidated budget, % GDP	-1.1	-1.0	-0.5

Source: State Statistics Committee, National Bank of Ukraine, Concorde Capital estimates

Prices for core commodities, as of July 8, 2008

	Current	%, YTD	%, yoy
Gas imports, USD/tcm	179.5	0%	38%
Crude oil (URALS), USD/bbl	137.0	49%	87%
Winter wheat, USD/mt, FOB**	292.0	14%	33%
Square billet, USD/mt, FOB**	1170.0	116%	139%

***Black Sea ports*

Source: Bloomberg, Metal-Courier

Rundown of June data

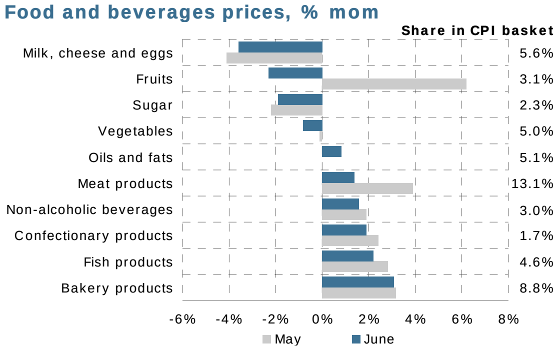
Today, the State Statistics Committee announced June's CPI and PPI numbers. In yoy terms, CPI decreased for the first time this year. The main drivers of June's CPI growth were food (0.6% mom) and utilities (2.0% mom), both accounted for 0.6% of CPI's 0.8% mom growth. In contrast, growth in producer prices accelerated, propped up on utilities (+8.9% mom), metallurgy (+6.6% mom), oil refining products (+5.2% mom) and machinery (+5.2% mom).

	% mom		% YTD		% yoy	
	May	**June**	**May**	**June**	**May**	**June**
CPI	1.3	0.8	14.6	15.5	31.1	29.3
PPI	3.7	4.2	24.2	29.4	39.4	43.7

Food prices calm down

Notably, food prices, the crucial contributor behind the current CPI surge, increased at the lowest rate month-on-month since March 2007. In yoy terms, food product prices grew 43.9%, down from 48.5% in May. Prices across the range of food products subsided significantly in June. The supply of newly harvested fruits and vegetables played a part, as did the seasonal correction on dairy and eggs.

Food and beverages prices, % mom



We contend that stabilizing food prices will induce a further slowdown in CPI and pull it back to 21.0% yoy by the end of 2008. There is a certain risk that unabated growth in producer prices will eventually reflect in consumer prices – this can be expected to be observed in late 2008 - early 2009: CPI performance tends to lag PPI with a half-year interval.

Government CPI forecast will tend to limit demand-side price pressure

This week, the Verkhovna Rada is scheduled to vote on the 2008 state budget amendments approved by the Cabinet of Ministers on July 5. Budget numbers were adjusted for the new CPI forecast (15.9% yoy in 2008, vs. previous 9.6%), which as before, we see as unrealistic. On a positive note, this could play an inflation-constraining role: social payments included in budget expenditures have not been upgraded as much as they would have been under a higher inflation target, therefore demand-side pressure on prices will be limited.

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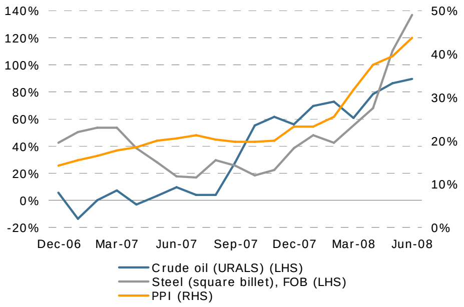
PPI and steel & oil prices



Source: Bloomberg, Metal-Courier, State Statistics Committee

PPI concerns…

Soaring commodities prices were the main motivator of the acute rise in Ukrainian producer prices: metallurgy +67.7% yoy, oil refineries +75.0% yoy in June. Moreover, a 4.2-4.9% price hike for electricity in June and bumping the special surcharge on domestically-sold gas from 4% to 6% for the chemical industry and from 8% to 12% for other industries resulted in a 8.9% mom spike in the utilities component of PPI. The latter sector contributed 1.6% of PPI's 4.2% mom advance. Unlike their consumer counterpart, producer prices are not as easy to tackle with monetary or fiscal policy, as they are strongly exposed to the fundamental long-term supply-demand patterns of both domestic and international markets. We retain our forecast of annual PPI growth at 33.0% in 2008, but will keep abreast of the situation.

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