

26 March 2012

Ukrainian Government Reshuffle

New faces, but expect more of the same until the election

- President Viktor Yanukovich has introduced six new faces to the Cabinet of Ministers since last November. The additions look designed to bolster credibility, both domestically and internationally, adding the first female minister and two well-connected businessmen (and fluent English-speakers to boot), one of which is not clearly pro-Yanukovich.
- At the same time, with parliamentary elections looming large in October and four of the new appointments Yanukovich loyalists that are likely to closely tow the party line, we do not expect a shift in overall government policy in the pre-election period.
- The window of opportunity for attempting unpopular but necessary reforms has long since passed. Recent election years in Ukraine usually see a mix of populism and overall political paralysis. 2012 should be no different, despite a turbulent global backdrop. Earlier this month Yanukovich announced social spending initiatives that government officials estimated could add up to UAH 16 bln (USD 2 bln) to the budget this year (equal to 4.5% of current planned expenditures).
- We continue to believe the Ukrainian government will meet its external obligations on time and in full, despite the obvious challenges and even without either signing a new gas deal with Russia or unfreezing the USD 15.5 bln IMF lending program. In February, the National Bank spent a mere USD 0.1 bln to support the hryvnya, which is a signal that external funding pressure is not high, while the NBU has enough reserves (USD 31 bln as of end-February) to cover FX market shortages, should they emerge.

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Political party tracker

Party	Support	Chg, yoy	
Yulia Tymoshenko Bloc	15.8%	+3.4 pp	↑
Party of Regions	13.9%	-12.8 pp	↓
Communist Party	5.3%	+2.4 pp	↑
Udar Party	5.1%	+5.1 pp	↑
Strong Ukraine Party*	3.6%	-7.5 pp	↓
Svoboda Party	3.6%	+0.2 pp	↔

* Merged with the Party of Regions in March 2012

Note: Support as of December 2011. Arrows indicate comparison of popular support in December 2011 vs. October 2010

Source: Razumkov Center survey

Politics watch list

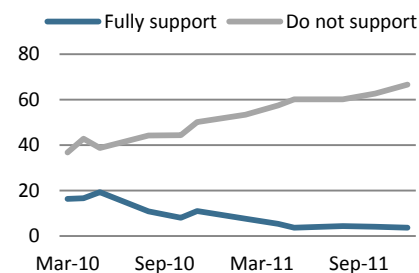
Initialing of EU Association Agreement	March 31
Putin's Inauguration in Russia	May 7
Resumption of Gas Talks with Russia	Mid-May
Opening Match of Euro-2012	June 8
Final Match of Euro-2012	July 1
Parliamentary Election Campaigning Begins	July 30
Parliamentary Election	October 28

Government reshuffle: More of the same

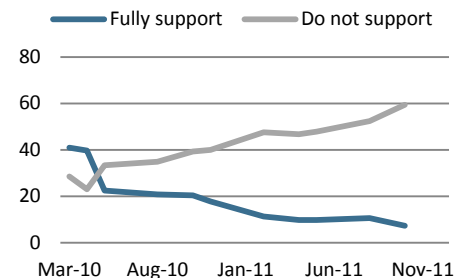
Makeover *looks* more investor-friendly, but no shift in policy is expected

President Viktor Yanukovich has carried out the biggest shakeup to the highest executive structure in the Ukrainian government since he was elected in 2010. In total, six new faces have been added to the Cabinet of Ministers since last November (see the list on page 4). On the surface, the moves look designed to bolster credibility, both domestically and internationally, adding the first female minister and two well-connected businessmen (and fluent English-speakers to boot), one of which is not clearly pro-Yanukovich. Following the new additions, the average age of the cabinet decreases by a full six years to 50.6.

Support for parliament's activities



Support for the president's activities



Source: Razumkov Center

At the same time, four of the appointments increase Yanukovich's grip on the executive, with loyalists in First Vice Prime Minister Valeriy Khoroshkovsky, Finance Minister Yuriy Kolobov, Defense Minister Dmytro Salamatin and Interior Minister Vitaliy Zakharchenko. Thus, with the president's influence at work behind the scenes, we do not expect a shift in overall government policy as a result of the reshuffle.

Reforms, IMF & gas deal all becoming more and more unlikely this year

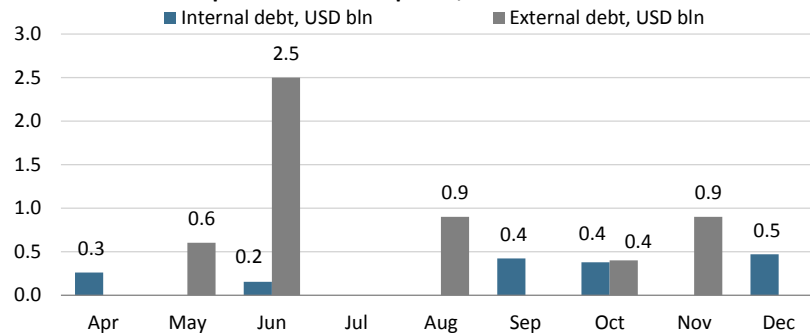
The government will only harden its policy course from now at least until the election, in our view. The window in which it would have attempted unpopular but necessary reforms has long since passed. Recent election years in Ukraine have been characterized by overall political paralysis. 2012 should be no different, despite a turbulent global backdrop.

The key political implications (at least until after the election) are:

- *No resumption in Ukraine's frozen USD 15.5 bln IMF lending program.* Government officials, all the way up to the president, are adamantly against instituting one of the last unresolved IMF demands: increase household gas tariffs. This is now politically impossible ahead of the election and failure to push this through will keep the IMF's coffers closed to Ukraine.
- *Difficult talks on a new gas deal with Russia, which could prove unfruitful.* Despite official comments in at the end of 2011 that a new deal for gas imports from Russia was imminent, nothing panned out. Yanukovich admitted just last week that there would be no progress until after Vladimir Putin is inaugurated as president on May 7. By then, Yanukovich might be desperate for a political win ahead of the election, but if Russia insists on any controversial concessions (i.e. a stake in Ukraine's gas transportation system, regarded a strategic asset - see our report dated December 22, 2011) – it could be a no-go domestically with under three months left by then until parliamentary election campaigns officially start.
- *No breakthrough in Association Agreement talks with the European Union.* It looks like Ukraine might get the go ahead from the EU on "initialing" (a technical term amounting to informal agreement on the terms) of a long-awaited landmark Association Agreement in the next 1-2 months. However, signing and ratification in EU member parliaments is off the table over EU concerns about Ukraine's democratic backsliding, rule of law and persecution of opposition politicians.
- *Populist initiatives.* Earlier this month Yanukovich announced a range of social spending initiatives, including raising the minimum monthly pension (UAH 822 currently) to UAH 100 to Ukraine's 9 million pensioners that retired before 2008 and paying back up to UAH 1,000 to depositors that lost money in the Soviet Savings Bank (Sberbank). Deputy Prime Minister Sergiy Tigipko estimated the new initiatives at up to UAH 16 bln (USD 2 bln), about up 4.5% of the current 2012 plan. There is little clarity yet on the sources for financing these initiatives, though Tigipko said it could come from increasing revenue from customs or the introduction of a luxury tax.

- No default.** Ukraine redeemed USD 0.6 bln in maturing IMF debt in February. The next peak in external debt payments is in May-June when Ukraine will have to pony up another USD 0.8 bln to the IMF, USD 2.0 bln to repay its loan from VTB (which we believe has a high chance of being restructured) and USD 0.5 bln to cover maturing Eurobonds. In February, the National Bank spent a mere USD 0.1 bln to support the hryvnya, which is a signal that external funding pressure is not high, while the NBU has enough reserves (USD 31 bln as of end-February) to cover FX market shortages, should they emerge. Our economists are confident Ukraine has enough ammo to satisfy its obligations this year on time and in full, even without new IMF funds or a revised gas deal with Russia.

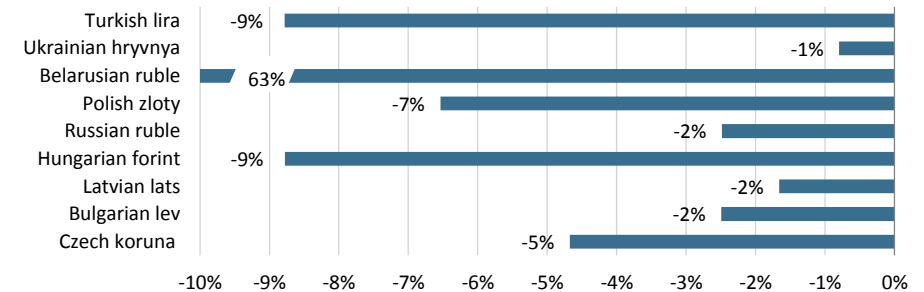
Ukraine's scheduled public debt redemptions, UAH bln



Source: NBU, Finance Ministry, Concorde Capital

- No devaluation.** The central bank's mandate ahead of the election appears to be hryvnya stability, having drawn a line-in-the-sand at UAH 8.0/USD. The government is eager to prove to the electorate it can handle economic pressure better than its predecessors in 2008-2009 when the hryvnya fell 40% vs. the US dollar. However, devaluation cannot be ruled out after October. Our base case forecast is for a UAH 8.2/USD exchange rate at the end of 2012.

Ukrainian hryvnya vs. other CEE currencies, Feb. 2012 vs. Feb. 2011



Source: Bloomberg

Euro-2012: Ukraine's "wag the dog" political event

Ukraine will co-host this year's UEFA European Football Championships with Poland. A successful event will go a long way toward mitigating the electoral impact of the government's unpopular political decisions, with the current government squarely responsible for preparations, and for most of June take most Ukrainians' minds off economic and financial woes. The timing could not be more ideal for the government – the final match in Kyiv will take place less than a month before the official beginning of parliamentary election campaigns.

Cabinet of Ministers: Who's in

Valeriy Khoroshkovsky. First Vice Prime Minister. Age: 43. Appointed: February 22, 2012. Previously was Minister of Finance (January 18, 2012-February 22, 2012), Head of the Security Service (2010-2012), Head of the Customs Service (2007-2009). Business assets (owned indirectly) include TV channels: Inter (Ukraine's most popular), Enter-Film, Enter-Music, NTN, K1, K2, and Megasport.

Petro Poroshenko. Minister of Economic Development & Trade. Age: 46. Appointed: March 23, 2012. Previously was Minister of Foreign Affairs (2009-2010) and Head of the National Security & Defense Council (2005). Business assets include the Roshen confectionary, Leninska Kuznya shipyard and Fifth TV channel. Made Forbes' 2012 list of billionaires, with a USD 1.0 bln net worth. Has been politically flexible and is not clearly pro-Yanukovych.

Raisa Bohatyrova. Vice Prime Minister & Minister of Health. Age: 59. Appointed: February 14, 2012. Previously was Head of the National Security Defense Council (2007-2012). Has held various other government positions since first elected to parliament in 1990, including Deputy and First Deputy Minister of Health (1994-2000). Educational background is in medicine, law and teaching.

Vitaliy Zakharchenko. Minister of Internal Affairs. Age: 49. Appointed: November 4, 2011. Previously was Head of the Tax Administration of Ukraine (2010-2011). Began his career as a police officer. Rumored to be a close to Yanukovych's family.

Dmytro Salamatin. Minister of Defense. Age: 46. Appointed: February 8, 2012. Previously was head of Ukroboronprom (since January 2011), the Ukrainian government body that develops, produces and sells military equipment to foreign countries, and prior to that head of Ukrspetsexport (since June 2010), the state-owned importer and exporter of military goods and services.

Yuriy Kolobov. Minister of Finance. Age: 38. Appointed: February 28, 2012. Previously was First Deputy Head of the National Bank of Ukraine (since December 2010). He was a member of the board and First Deputy Head of Ukreximbank (April 2010-December 2010), an advisor to the head of Oshchadbank (2009-2010), chairman of the board of BTA Bank (2008) and head of treasury at Oshchadbank (2003-2008). Rumored to be close to Yanukovych's oldest son, Oleksandr.

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