KYIV POST
Independence. Community. Trust.

Solving inflation not so simple

by Alina Pastukhova, Kyiv Post Staff Writer Zenon Zawada, Kyiv Post Chief Editor
May 15 2008, 03:54

Photo by Ukrinform
Shoppers examine varieties of Ukrainian kovbasa at a market in Ivano-Frankivsk in late April. Meat prices are among the biggest sources of inflation in Ukraine.

Ukraine's inflation is the highest in Europe and the nation's biggest economic threat, which politicians and pundits are trying to solve.

When Washington economist Anders Aslund rolls into Kyiv for a few days in his Burberry coat and carrying a black Peterson Institute briefcase, it typically means a pressing economic issue is at hand.

In this case, it's Ukraine's inflation, the highest in Europe and the nation's biggest economic threat, which politicians and pundits are trying to solve, or in some cases exploit.

In a strange display, Prime Minister Yulia Tymoshenko ordered her own parliamentary faction, part of the coalition government, to block President Viktor Yushchenko from delivering a May 13 address to parliament, claiming its leadership was obstructing three anti-inflationary bills to be considered for a vote.

The president accused Tymoshenko of grandstanding to re-position herself as an inflation warrior, insisting the best means to combat inflation is passing a balanced budget that limits social spending.

Consumer prices rose 26.2 percent from the same year-ago month in March, the highest surge in eight years.

The Cabinet of Ministers' inflation projection was 9.6 percent for 2008, while first-quarter inflation was 9.7 percent compared to the prior quarter.

Tymoshenko denied any responsibility since taking over the government in late December, insisting she inherited the inflation from the government of former Prime Minister Viktor Yanukovych.

Inflation was 17 percent in 2007 when he led the Cabinet of Ministers.

Tymoshenko's opponents, which include the president and Yanukovych's Party of the Regions of Ukraine, the nation's biggest political party, claim it's the prime minister who's responsible, largely because of the social payments she delivered as her first major move as prime minister.

In fact, most economists recognize that a significant portion of Ukraine's inflation is beyond any prime minister's influence.

Global agricultural prices have increased significantly, which particularly affects the Ukrainian economy because food prices comprise about 70 percent of the Ukraine's consumer price index, according to Washington economist Aslund, far more than developed countries, where it's typically closer to 50 percent.

Meanwhile, rising incomes are another critical factor, said Oleksandr Zholud, an economist at the

Western-financed International Centre for Policy Studies in Kyiv.

Real disposable income rose by 19.8 percent in the first quarter of 2008 from the same year-ago period, Kyiv investment bank Alfa Capital reported, while nominal income rose 46.4 percent.

"It was accompanied by a 43.2 percent surge in nominal household spending, but given the annual CPI of 26 percent in March, the faster dynamics mean a deceleration in real terms," Alfa Capital reported.

Another inflationary factor is the Ukraine's hryvnia peg to the US dollar.

While the dollar has gradually deteriorated against the euro, the official exchange rate hasn't budged from 5.05 hryvnias to $1, where it's been since Tymoshenko first became prime minister in February 2005.

In mid-March, the National Bank of Ukraine chose not to intervene when dollars were pouring into the market, leading observers to believe it was cushioning Ukraine's inflation woes.

The dollar now buys between 4.60 and 4.80 hryvnias, which many economists interpret as a transition.

Aslund has been among the biggest advocates of allowing the hryvnia to float, and he met with virtually every top government official during four days in late April to urge its immediacy.

"Floating the exchange rate will allow less inflationary pressure from abroad," he said.

A fierce critic of Tymoshenko in her first term, Aslund is now an ally. The Odesa Portside Plant, Ukraine's biggest nitrogen fertilizer and ammonia producer estimated at $1 billion, must be privatized, and the revenue could just as well go to fund Tymoshenko's further social payments, he said.

Meanwhile, the $700 million spent by Tymoshenko in compensating bank depositors the savings they lost in the Soviet Union's collapse had a negligible effect on inflation, he said.

"It's a lot of noise about something rather small," Aslund said.

The hryvnia must be floated, economists agreed. It's only a matter of how soon and how much.

The exchange rate should be liberalized gradually and slowly, Zholud said, predicting an exchange rate of 4.50 hryvnias per $1 by the year's end.

Floating the hryvnia will reduce inflation, projected at around 20 percent for this year, by 12 to 15 percent, Aslund said.

"The transition is beginning," Aslund said. "I am making sure it happens."

Go back