Flash Comment

October 27, 2008

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CEE: Markets fail to respond to IMF packages

Yesterday, the Ukraine received a USD16.5bn loan from the IMF and the IMF at the same time said that it would agree with the Hungarian government on a rescue package in the coming days. Under normally circumstances this would be good news for CEE assets. However, it seems like the markets are totally giving up on CEE. This morning the Hungarian stock markets have dropped more than 10% despite the promise of an IMF package.

IMF's package for the Ukraine is quite large taking into account that IMF's total funds available for such distribution are about USD220bn. Furthermore, the package is of a similar size to the package Turkey got in 2002 after the collapse of the Turkish economic and financial system. This is a clear indication that the IMF sees the risks in the Ukraine as extremely high. Furthermore, the fact that the IMF acts this fast (relative to what it did with Turkey in 2001/02) is a clear indication that the IMF fears a domino effect in central and eastern Europe where a collapse in one country "automatically" led to a collapse in another country. There is also no doubt that Ukraine's geopolitical importance has played a role in IMF's swift action. After the outbreak of the Russian-Georgian conflict the tensions between Russia and Ukraine have increased significantly and there is no doubt that Western policy makers are worrying that an economic and financial collapse in the Ukraine could add seriously to domestic political unrest in the Ukraine between pro-western and pro-Russian forces.

There is no doubt that the IMF will have to take over responsibility for economic policy in the Ukraine given the size of the loan. However, given the very high degree of political uncertainty and widespread corruption in the Ukraine there is a serious risk that the IMF will fail to implement the desired reforms. That said the IMF could provide a positive anchor for economic policy – as it has done in Turkey since 2002 – that will have significant positive impact on the Ukrainian economy.

Concluding, it is worrying that the CEE markets continue to sell-off despite IMF's clear commitment to support the region's markets and economies. One might in fact see the lack of positive response to IMF's rescue packages for Hungary and the Ukraine as an indication that these packages are in fact making the markets even more nervous that something "is seriously wrong in CEE". That said, the rescue package for the Ukraine is substantial and if implemented with the right economic reforms it should do a lot to improve the Ukraine's economic and financial system.

We will be watching very closely in the coming days for more details on the Ukrainian and Hungarian IMF packages and to what extent the EU and ECB will get more involved in crisis resolution in CEE.

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First date of publication
Please see the front page of this research report.

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