

# Ukraine Business Forecast Report Q1 2015

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## Abstracts

### Core Views

Ukraine's economy is headed for a major recession which it is unlikely to emerge from until 2016. Ongoing fighting between the Ukrainian army and pro-Russia forces in the east, and the persistent threat of a military invasion by Russia, raises huge challenges to our ability to forecast the economic outlook over the coming quarters to any meaningful degree of confidence.

EU/IMF financing package will require reforms, including: FX liberalisation (although this is likely to be implemented in stages), partial removal of gas subsidies and potentially pension reform.

Despite the new IMF package, Ukraine's fiscal position remains poor and is likely to deteriorate over the coming quarters. FX shocks, extended fighting and the growing risk of a banking sector bailout all pose significant challenges to the sovereign debt profile. Ultimately, we believe that Ukraine's debt load is likely to become unsustainable, necessitating a debt restructuring further down the line.

Putin will be happy with Crimea for now, and will not push military intervention into North East of Ukraine. Ethnic divisions in NE Ukraine not nearly as clear cut as Crimea, and it would benefit Putin to retain a large ethnic Russian influence in mainland Ukraine (enabling him to maintain a direct political stake in Ukrainian affairs).

### Major Forecast Changes

We have revised up our 2014 real GDP estimate slightly, although we emphasise this is because we have adjusted our GDP forecasts to exclude Crimea in order to keep our statistics consistent with the national statistical agency's decision. The deeper than

expected devaluation will also reduce imports more than we initially forecast, reducing the drag from weaker exports. We estimate real GDP will contract by 5.3% in 2014, and forecast a further contraction of 5.2% in 2015.

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Conflict To Escalate; No Early Lifting Of Russia Sanctions  
The fighting in Eastern Ukraine will escalate in the near term, with a high risk of new fronts opening up, but the endgame remains a stalemated conflict. Given current security dynamics, there will be no lifting of Western sanctions on Russia until well into 2015 at best.  
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Any US provision of lethal equipment to Ukraine would risk escalating the conflict substantially. As such, Washington will adopt a 'wait and see' approach in the near term, and calibrate its policy according to Russia's next steps.  
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