

# Ukraine Business Forecast Report Q3 2014

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## Abstracts

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### Core Views

A EU/IMF financing package will require reforms, including foreign exchange liberalisation (although this is likely to be implemented in stages), partial removal of gas subsidies and potentially pension reform. An emergency financing package without conditions may be provided in order to prevent default in 2014. Russia will not relinquish Crimea, although whether it becomes part of a semi-independent state (eg Transnistria, Abkhazia etc), or more formally part of the Russian Federation is hard to call. To limit fallout with the West, we think the former is most likely, but a recent vote by the Crimean parliament to join Russia may push its hand. We see political risks as likely to threaten growth over the next 12 months as the government is forced to decide over closer relations with the EU or Russia. President Vladimir Putin will be happy with Crimea for now and will not push military intervention into north-east Ukraine. Ethnic divisions in northeast Ukraine are not nearly as clear-cut as in 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 downgraded our outlook for real GDP growth for 2014, and now expect GDP to contract by 4.1% in 2014. This change reflects our expectations for hryvnia devaluation and the concomitant impact on household purchasing power, the Crimean conflict dampening fixed investment, and expectations of a retrenchment in government spending.

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SWOT Analysis

BMI Political Risk Ratings

Domestic Politics

Poroshenko Victory Could Mark Ukraine's Turning Point

The landslide victory for Petro Poroshenko in the first round of Ukraine's presidential elections held on May 25 marks the best-case scenario for the country, despite disruption to voting in several areas in Eastern Ukraine. Nonetheless, considerable economic and political challenges must be addressed over the coming months.

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A More Dangerous And Uncertain Future

The very survival of the Ukrainian state in its present form is in question. President Petro Poroshenko will struggle to govern the country, which could yet face greater separatist pressure over the coming years.

### CHAPTER 2: ECONOMIC OUTLOOK

SWOT Analysis

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Deep Recession In 2014

We forecast Ukraine to experience a sharp recession in 2014, driven by the devaluation of the hryvnia and major trade disruption due to the elevated risk of a military escalation with Russia. Soaring inflation, substantially tighter government spending, diminished purchasing power and extremely tight credit conditions will also contribute to the dismal economic outlook.

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Devaluation To Drive Major Narrowing Of Current Account Deficit

The collapse of the hryvnia is driving a major balance of payments correction in Ukraine, and we forecast the current account deficit to arrive at just 1.5% of GDP in 2014, from 7.1% in 2013. The collapse of the hryvnia has substantially eroded household purchasing power, which will reduce consumer imports. Additionally, the threat of military escalation has led to disruptions in trade credit and insurance underwriting, and consequently major falls in trade flows. However, we expect the current account deficit to widen slightly in

## **2015 OWING TO A NORMALISATION OF TRADE FLOWS AND A SLIGHT STRENGTHENING OF THE HRYVNIA.**

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