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A strange kind of stability

Slow, patchy reforms as president avoids triggering the public

The Ukrainian government is currently enjoying the most stability since the EuroMaidan revolt of the winter of 2013-2014. This has been achieved by its government leaders tactfully avoiding pushing any political triggers that would provoke an otherwise discontent population to protest, such as approving legislation to hold local elections in the occupied region of Donbas and then grant the region autonomy.

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Even large utility rate hikes failed to prompt a protest movement as the government coupled with them subsidies for a majority of households and wage hikes for many state workers. **We expect the government will continue to deliberately avoid these trigger issues. The situation is so stable that we see no major game changers for the entire winter, whether positive or negative.** The president had been promising by November a visa-free regime to allow Ukrainian citizens free travel to the EU, which would have boosted his popularity immensely. But we view it as unlikely given the resistance in the European Parliament and some diplomats.

Such a period of stability should be taken advantage of by the government to accelerate reforms and anti-corruption measures. Yet the pace remains sluggish, with the government still showing resistance to certain measures. **What we refer to as “systemic reform,” particularly in spheres critical to foreign investment such as the judiciary and law enforcement, isn’t happening in a meaningful, systemic way,** partly because Western institutions have no mechanisms to influence the process. Meanwhile, the will is simply lacking locally.

What we refer to as “piecemeal reforms” – largely to satisfy the IMF – are under way for the pension system, the judicial system, state enterprises, and the privatization process. More anti-corruption reforms are being demanded by Western institutions, including the establishment of special courts and the enhancement of the investigative authority of the National Anti-Corruption Bureau, considered to be the most independent. **Yet the West and the Ukrainian public remain dissatisfied with the overall pace and scale of reforms.** The IMF loan tranche issued in September was USD 1.0 bln instead of USD 1.7 bln owing to lackluster progress.

Though it no longer attracts the West’s attention, **armed fighting is active in the Donbas region,** inflicting a handful of casualties or injuries every week. We believe the goal of the Russian government is to drag out the Donbas conflict in order to exhaust the European public (disinterested in war) and business community (interested in renewing business) and prompt them to support the easing of sanctions by their legislatures, which could begin in the second half of 2017, given the current political trends. The lifting of sanctions could lead to a frozen conflict, as defined by a total cease-fire in the absence of a political solution.

Just how the Russian-Ukrainian conflict will be resolved remains unclear, but we see the U.S. presidential elections playing a critical role. **We believe the conflict has a higher potential to intensify should Hillary Clinton become U.S. president, and we see peace – however temporary – being more possible should Donald Trump get elected.** He has already indicated his willingness to ease sanctions in relation to the illegal Crimean annexation. Though the U.S. Congress is unlikely to support such measures, we believe his election and foreign policy will feed the momentum for a détente with Russia, both in the U.S. and in Europe, particularly with crucial French and German elections on the slate for 2017.

THE POLITICAL PARADIGM

Poroshenko consolidates power with opposition neutralized

As Ukraine enters the fall political season, it's enjoying a period of stability unseen since the start of the EuroMaidan protest in November 2013. **Both the president and the prime minister are on the same team rather than competing with each other**, as had been the case for nearly two years with President Petro Poroshenko and former Prime Minister Arseniy Yatsenyuk, who resigned in April 2016.

Although Poroshenko and Prime Minister Volodymyr Groysman are both not very popular, **no political force poses any challenge to their rule and they look to remain in place through the winter's end, at minimum**. While an expectation to remain in office for six months might not mean much for a Western prime minister, it's a welcome mark of long-awaited stability in Ukraine, particularly during wartime.

Poroshenko also consolidated power by getting five allies appointed as deputy prime ministers. Besides domestic affairs, he deeply influences the defense sector, the foreign ministry, the Prosecutor General's Office, the Security Service and the National Bank. However, the president has yet to demonstrate systemic, comprehensive reform with this newly consolidate power. A positive step in that direction was legislation approved in early June to improve the judiciary's independence and accountability.

Instead, Poroshenko has maintained his wide authority by avoiding **any triggers to stir an otherwise dissatisfied population to widescale protests**. Aside from numerous sensitive triggers related to the war in Donbas, other potential triggers were harsh utility rate hikes, including 28 percent for electricity as of Sept. 1 and doubled rates for hot water and heating as of July 1, which are largely owing to higher natural gas prices that took effect May 1. **The government succeeded in relieving much of the stress from the rate hikes by offering subsidies**, covering about 60 percent of households, and raising wages for many state workers from between a third to even double, which came as a relief after the post-Maidan devaluation (2014-15) reduced wages to a fraction of what they were. These subsidies are not to exceed deficit limits established by the IMF however.

The Cabinet led by Groysman delivered another pleasant surprise in mid-September when it submitted the first complete budget draft on deadline. Typically, this version is a reprint from the previous year that is usually further adjusted until a chaotic New Year's Eve vote. This year, MPs will be able to enjoy the holidays without such stress as the first reading was approved on Oct. 20, also on deadline. **Not only was the 2017 budget complete, more or less, but it was met by wide approval among Ukraine's financial community**.

Groysman's Cabinet gained a key endorsement from the West on Sept. 15 when the IMF released a USD 1 bln IMF tranche, which will enhance reserves and stabilize the national currency, which was volatile in the late summer. **The tranche sends the signal to the Ukrainian public that the West is more-or-less satisfied with the current government, though it was widely recognized as a political decision**. The tranche was originally planned at \$1.7 billion and the IMF cited a lengthy list of reforms that are still needed.

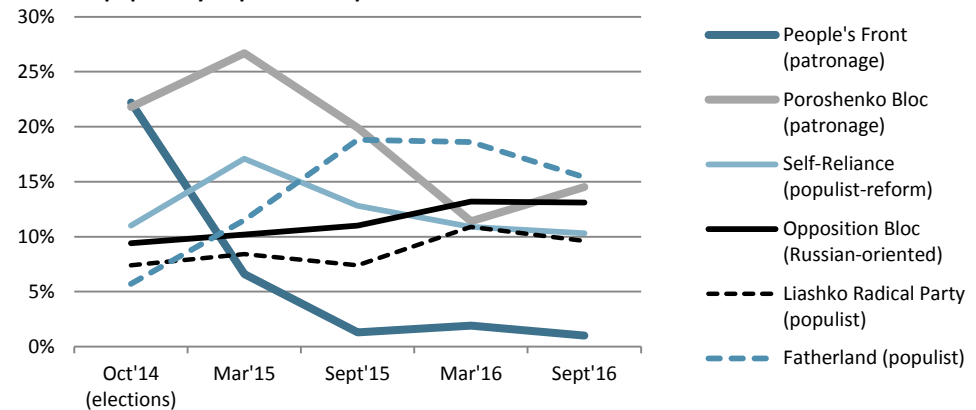
Among the strange aspects behind the current stability is that the parliament doesn't appear to have an official majority. When the governing coalition was formed in April between the Poroshenko Bloc and People's Front parties, they were accused of not having enough votes to form a majority. And indeed, to this day they lack two MPs of the 226 needed. Yet the overall situation is stable enough that the opposition can't exploit this shortcoming to destabilize the government.

Impotent opposition despite unpopular government

The current stability is quite an achievement for President Poroshenko in light of his wide unpopularity. He finished in second place in an early June presidential poll, with only 14% of Ukrainians saying they'd vote for him. In the same poll, 12% of respondents said they trust Groysman, while 51% said they don't. **This poor support is largely due to the ongoing war, a lack of systemic reforms, and utility rate hikes amid a stagnant economy.**

The opposition, led by pro-Western populists Yulia Tymoshenko and Oleh Liashko, aimed to capitalize on this poor approval this summer by hammering the government on the rate hikes, **with no success in mobilizing the public.** Nonetheless, Tymoshenko is the most popular politician at the moment, with 24% of the public ready to vote for her as president and 15% willing to vote for her party, which also ranks first. Her latest attacks have been directed at the National Bank head, who is an easy target because of the weak economy and her close ties to Poroshenko.

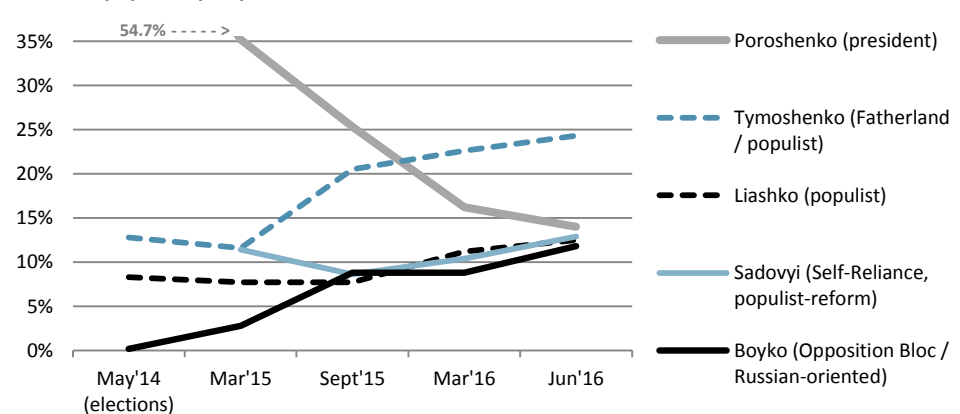
Electoral popularity of parliament parties



Sources: Kyiv International Institute of Sociology, Central Election Commission, Concorde Capital calculation

This pro-Western opposition has been more of a factor than the Opposition Bloc, a Russian-oriented party that consists of holdovers from former President Yanukovich's defunct party. **It has been acting mostly behind the scenes,** working to protect its members from prosecutions and to release frozen assets. They also continue to pursue business deals. Despite its largely negative role in Ukrainian politics, the Opposition Bloc would earn 13% of the vote, or third most, solely because of the Russian-oriented electorate in the southeastern regions.

Electoral popularity of president candidates



Sources: Kyiv International Institute of Sociology, Central Election Commission, Concorde Capital calculation

Potential game-changing events

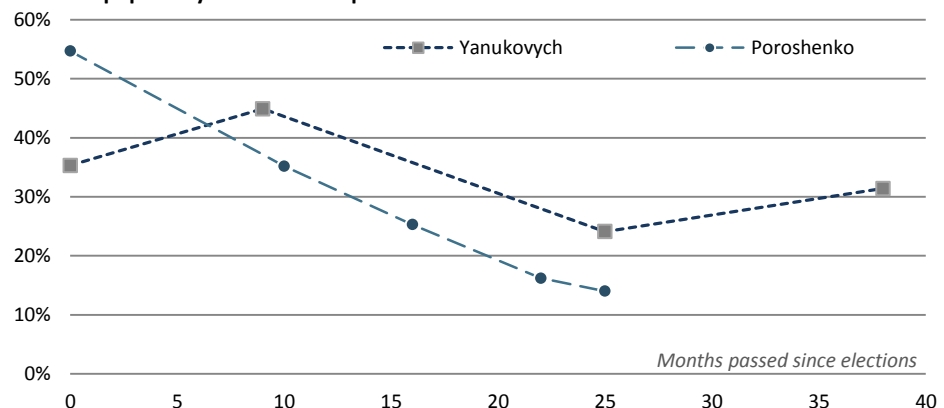
In the next six months, there are several foreseeable “game-changer” political events that have the potential of undermining the government’s comfortable position or triggering the opposition forces with much-needed momentum. **We see it as highly unlikely that any of the triggers will occur and as a result, we are confident that the political and economic situation in Ukraine will be stable at least until the spring.**

Donbas elections/special status (20% likely) – the Minsk Two Accords of February 2015 to resolve the armed conflict in Donbas require local elections to be held, yet they’re opposed by more than half the public, according to polls. That’s also the case for the next step of amending the constitution to create a “special status,” or de facto autonomy for the region. **The president is well aware of the explosive nature of these issues and we are confident he will be very careful to avoid triggering them.** All the while, he will continue to assure his anxious Western counterparts that elections will be held, making general statements and reaching auxiliary agreements to Minsk Two. A road map is currently being drafted that will call for, among other things, the OSCE taking control of the contested border ahead of the elections. Both the Russians and Ukrainians know this road map is highly unlikely to be fulfilled. Poroshenko will continue play this Ukrainian “double game” with his counterparts for as long as he can.

Military draft (20% likely) – the president claims that he has enough professional soldiers – 50,000 joining this year alone – to fight the war in Donbas without having to call another round in the draft. That will only be necessary if Russia intensifies its military aggression again. That’s good because another round has the potential to trigger a protest wave.

EU visa-free regime (20% likely) – the government would benefit enormously from a decision to allow Ukrainians to travel visa-free to the 28 EU member-states. The European Parliament decided on Oct. 11 not to consider it that month, though the European Commission confirmed its support a week later. The parliament then excluded the proposal from its November legislative agenda. A final decision had been expected to be announced at the Ukraine-EU summit scheduled for Nov. 24. Though intended as a temporary travel pass, the visa-free regime would result in hundreds of thousands Ukrainians pursuing employment in the EU, whether legally or illegally. **The measure would release a great deal of accumulated economic frustration mounting within the country this year. Yet we see a low likelihood that the European Parliament will extend its approval, considering the current anti-migrant sentiment in Europe.** Moreover, the EU would severely worsen its relations with Turkey, whose president has also demanded visa-free travel, if it was extended to Ukrainians and Georgians.

Electoral popularity of incumbent president since his election



Sources: Kyiv International Institute of Sociology, Central Election Commission, Concorde Capital calculation

DOMESTIC AFFAIRS

Reluctant elites still piecemealing reforms amid mounting “Ukraine fatigue” in the West

Anti-corruption – the global establishment is watching Ukraine not only for the Donbas war, but just as importantly the government’s anti-corruption and reform efforts, which are occurring too slowly and lacking a systemic approach. **With its September loan tranche, the IMF indicated the government is doing just enough to maintain Western support.** At the same time, Managing Director Christine Lagarde said there remains “much to be done” and NGO leaders acknowledged the decision was politically motivated.

Indeed the latest anti-corruption scandal – drawing attention from key EU officials – erupted in late August, when the government was accused by civic activists and NGO leaders of deliberately derailing the launch of an electronic assets and income declaration system for all government employees, including the highest elected officials. After a critical letter from EU leaders, the Ukrainian president personally assured the public the system would be launched. **By October’s end, almost all MPs had submitted their declarations,** though they were less-than-honest, to say the least. Moreover, the public was shocked to see how little trust they had in the nation’s banking system, with alarming amounts of wealth kept in foreign currency, and in cash.

The IMF published in early October its next benchmarks to achieve the fourth loan tranche of USD 1.3 bln, which are led by a bill to create an agri-land market and restrict utility subsidies from swelling the deficit. Other IMF recommendations are overhauling the pension system (which is widely abused), implementing a mechanism to regulate heat and gas rates in case they get excessive, approving a more transparent privatization process, and selecting a final list of state enterprises to be privatized or liquidated.

Law enforcement – this summer, officials in the Prosecutor General’s Office engaged in a violent conflict with employees of the National Anti-Corruption Bureau, which generally enjoys a positive image as Ukraine’s only independent law enforcement agency. The conflict – over surveillance authority – seems to have cooled off with the arrival of autumn winds, and the IMF is requiring even more independent investigative authority for the Anti-Corruption Bureau for Ukraine to gain the next loan tranche. Prosecutor General Yuriy Lutsenko indicated he could resist such efforts.

Judicial reform – perhaps the sector most desperate for reform, progress was made in June with legislation that makes judges more independent from politics and holds them accountable for their rulings. Yet rule of law remains among the biggest problems for businessmen. Even recently, **lawyers for the newly appointed stakeholders in Mriya alleged they are having trouble getting honest and expedient court decisions** in their attempts to recover assets in a messy corporate takeover after the company was allegedly hollowed out. A deputy justice minister even recently acknowledged that 90% of corporate raids were successful last year.

Prosecuting the crimes of the Yanukovich administration has fallen off radar screens entirely. The deadline expired in September for filing criminal charges against the Constitutional Court judges who enabled Yanukovich to usurp authority in 2010. **Prosecuting the crimes of current officials is extremely patchy as only mid-ranking officials have been targeted, and only those without the protection of a coalition party (Poroshenko Bloc or People’s Front).** While charges were filed against mid-sized businessman Oleksandr Onyshchenko, he was able to flee the country. Last month, a Higher Justice Council judge was accused by the prosecutor general of demanding a bribe of USD 500,000 in exchange for a judicial ruling. Yet he was released on bail and given vacation leave pending the investigation.

The EU is currently demanding that parliament approve legislation establishing special anti-corruption courts, without which it will be difficult to combat corruption, in the view of the National Anti-Corruption Bureau's head (who would directly benefit).

Agricultural land market – the IMF has required land reform legislation being submitted to parliament. Yet instead, the parliament and president decided to extend the moratorium on agricultural land sales for the eighth time in the last decade. **Ukraine is among the few countries in the world where the trade of agricultural land is forbidden, in addition to neighboring Belarus.** Legislation has already been drafted that allows leaseholders to trade their agreements or use them as collateral. It lacks wide support because they would be able to do so without the permission of landlords. The other proposals call for the establishment of a land parcel registry in order to set up a market, which would be done in stages. Populists have led the campaign against a land market, which is desired by frustrated corporate farmers who have to deal with a highly bureaucratic and inefficient system at present.

Tax reform – the most notable change in the tax regime will affect agricultural producers, who had to go from enjoying a special account into which they paid their value-added tax to having to pay directly to the central budget this year (50% of VAT for meat producers and 85% for grain producers.) Lobbyists are currently fighting a proposal for next year that they pay all their VAT to the central budget. The 2017 budget also calls for canceling VAT exemptions for education and transport services, and raise the VAT rates for medical items to 10 percent from seven percent. When including excise duties that are projected to rise further across the board as of Jan. 1, these tax changes will add UAH 37 bln in budget revenue (USD 1.4 bln), as estimated by the CASE Ukraine Center for Socio-Economic Research.

Privatization – the State Property Fund has until end-October to determine which state enterprises will be sold off, and which will be liquidated altogether. Among the key assets still being planned for sale are the Odesa Portside Plant that produces nitrogen fertilizers, the Turboatom company that produces steam turbines for thermal and nuclear power plants, producer of power generators Elektrovazhmash, the United Mining and Chemical Company, the Zaporizhia Titanium Plant and the State Food and Grain Corporation. **As many as 330 state enterprises could be on the list**, the Economy Ministry reported in late August. The fund has also prepared legislation that will enable potential investors to get more time to learn about assets. Ministries would be eliminated from the process of preparing assets for privatization. Penalties will be imposed on fund officials for dragging out the process.

Foreign currency exchange – the National Bank of Ukraine has taken numerous steps towards softening restrictions on the foreign currency market since the summer, including gradually easing the limit on foreign currency withdrawals of the equivalent of UAH 250,000 per day from UAH 100,000 as of September. In another decree that month, the NBU prolonged for three months the requirement for exporters to sell at least 65% of foreign currency-denominated proceeds, which was lowered from 75% in June. Export proceeds can be returned within a period of 120 days, which was raised from 90 days in late July. The regulator also allowed purchasing foreign currency for external debt servicing even if an entity has its own foreign currency in accounts.

Regulation of dividends – the NBU prolong for three months its June rule on repatriation of dividends, according to which only dividends for 2014-15 are allowed to be repatriated, with monthly limits of USD 1-5 mln, depending on their volume.

We expect no further significant easing of restrictions through the year end. NBU Head Valeria Gontareva said in mid-September that no further easing in the ForEx will occur unless rules for moving profit abroad will be clarified and enforced. A much-needed measure would be the removal of the National Bank's tight currency control over export-import operations.

THE FRONTLINE WITH RUSSIA

The Donbas war

Though it has fallen off the radar screens of the Western media, the Donbas war is still raging, inflicting a handful of casualties or injuries every week. **The peace talks – both at the heads of state level and those in Minsk involving the Russian-backed forces – lost any and all momentum this summer and are back to Square One.** The world has largely recognized the failure of the Minsk Two Accords, forged in February 2015, though diplomats are continuing to try to implement them with the latest road map revealed in mid-September.

We are confident the Minsk Two Accords will never be fulfilled largely because the Russians never intended for them to succeed when helping to draft them. As the most powerful player in the conflict, the Russians could end the conflict tomorrow with steps such as removing its soldiers and armaments, restoring Ukrainian control of the border and allowing the OSCE to ensure peace is upheld. **Instead, we believe the Russian intention with the accords was to allow Western leaders to hang themselves with their own rope.** By undermining Western approaches to the conflict, such as organizing cease-fires and calling for elections, the Russians are better able to argue before the public in the West that it's the Ukrainians who have failed to live up to the peace treaty and therefore the sanctions against Russia deserve to be dropped.

The West had aimed for the sanctions to exhaust, and possibly collapse, the Russian economy by 2017 and force Putin to withdraw from Ukraine without the disastrous consequences of using military tactics. **Yet instead, it's the Russians who have been more successful in tiring the West, with the latest wave of "Ukraine fatigue" already setting in.** For example, at the last Normandy Format meeting in September, French President Francois Hollande even called for Ukraine to organize the local elections without restoring control over the contested border, something President Poroshenko can never agree to lest he trigger an anxious public.

Ultimately, the Kremlin wants to exhaust the West at all levels – the public, the business community and the political class – which would pave the way for legislatures and state executives to begin dropping sanctions, which we believe is possible in the second half of 2017. **The removal of sanctions related to Crimea would open an opportunity to create a frozen conflict in Donbas, in which all military activity is halted but no political resolution is reached.**

The Trump card in Crimea

Just as far off radar screens are the ongoing sanctions to pressure Russia to abandon its annexation of Crimea. Russian President Putin has made clear that he will not withdraw from Crimea under any circumstances, ignoring ongoing economic pressure produced by the sanctions. **The current Russian lobbying campaign in Western legislatures and political parties is aimed at removing sanctions related to Crimea primarily, with Donbas-related sanctions likely to follow.**

It has produced minimal results so far. In June, the French Senate sent an appeal to the Cabinet requesting a reduction in economic sanctions against Russia. A Belgian MP followed suit in July, registering a resolution that contained all the Kremlin's talking points. **No Western legislature has yet to support lifting sanctions.**

The U.S. Congress won't support any attempt either, even if Republican candidate Donald Trump is elected. However, a Trump presidency can create momentum on behalf of Russia. Having already declared a priority of recruiting Russia to fight radical Islam, Trump is clearly willing to make concessions to Putin. Most notably, he said he's indifferent about Ukraine's NATO membership and that Crimeans prefer to be under Russia, a clear signal of his willingness to trade Crimea for concessions. Among his few foreign policy advisors, Carter Page, has close ties to Russian investors and has voiced foreign policy positions highly sympathetic to the Kremlin.

However, Trump has also shown understanding for the Ukrainian cause, **assuring the public that he won't allow Putin to go any further militarily.** Newt Gingrich, who could be advising Trump closely on foreign policy, in Kyiv this fall that **the U.S. is interested in Ukraine being able to defend itself and Trump could be open to selling arms to the Ukrainian government,** which has been actively lobbying the U.S. for donations, to no avail.

Trump's hints of his openness to dropping sanctions could affect the mood in Europe, whose residents have been more directly affected by Russia's countersanctions, such as billions in euros in lost EU food exports. **Another major litmus test will be the April-May 2017 election for the French presidency.** Among the candidates, Nicolas Sarkozy, is widely recognized to be also warming up to Putin. The Bundestag elections slated for September will likely demonstrate swelled support for the anti-immigrant parties, which are traditionally aligned with Russia. That could also produce a center-right chancellor sympathetic to Putin, similar to Sarkozy.

We don't share the view that Russia would extend its military aggression if the sanctions are removed. The Russians can't afford to continue this war, let alone expand it, and are looking for any face-saving option to resolve this conflict. **But the only way for Putin to emerge without losing face must involve being able to retain control of Crimea.**

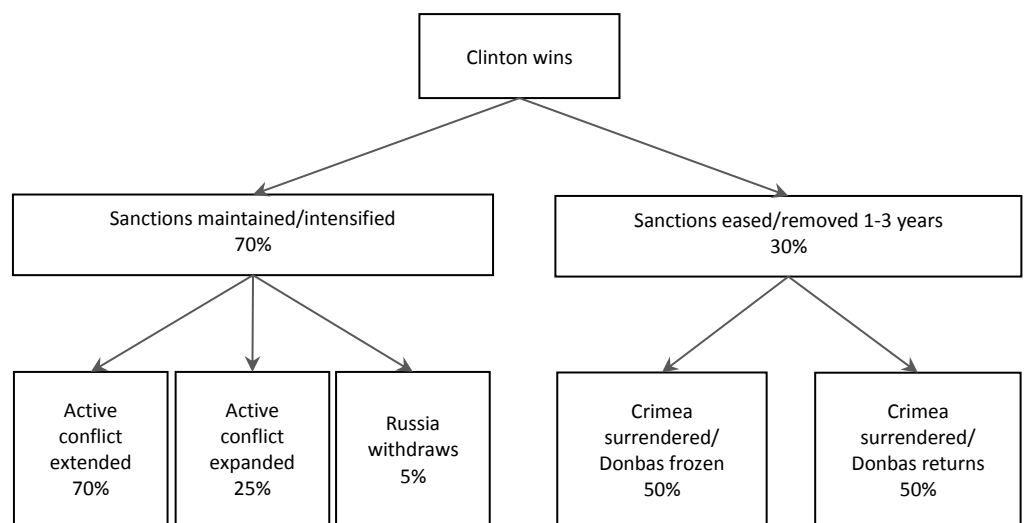
Scenarios to resolving conflict over Ukraine

We see even chances between Hillary Clinton and Donald Trump to win the Nov. 8 elections. Since we view a frozen conflict as the best viable option for Ukrainian business, we see the election of Trump as better for Ukraine in the short- to mid-term (one to three years). Ideally, this frozen conflict would be created without the surrender of Crimea-related sanctions. But realistically, the next U.S. president could lead the Europeans and the U.S. Congress in conceding Crimea to the Russians in exchange for freezing Donbas. **Only Trump would be open to trading Crimea for Donbas, while Clinton will not consider this option.**

At the same time, it's worth pointing out that the Ukraine policies of both candidates could lead to risks for serious political destabilization in Ukraine. While there's a risk of an exacerbated proxy war between the West and Russia in the event of a Clinton presidency, there is also the risk of civil war in Ukraine should Trump offer too many concessions to Putin. **Ironically, the fulfillment of the Minsk Two Accords could prompt this civil war, as attested to by numerous Ukrainian political experts, and that's why we view a frozen conflict as a better way out.**

We analyzed the possible scenarios for the Ukraine conflict will unfold in the case of either victory in the following charts. We also discuss below the two most likely scenarios under either victory.

Clinton Wins



1. Sanctions maintained/intensified, active conflict extended

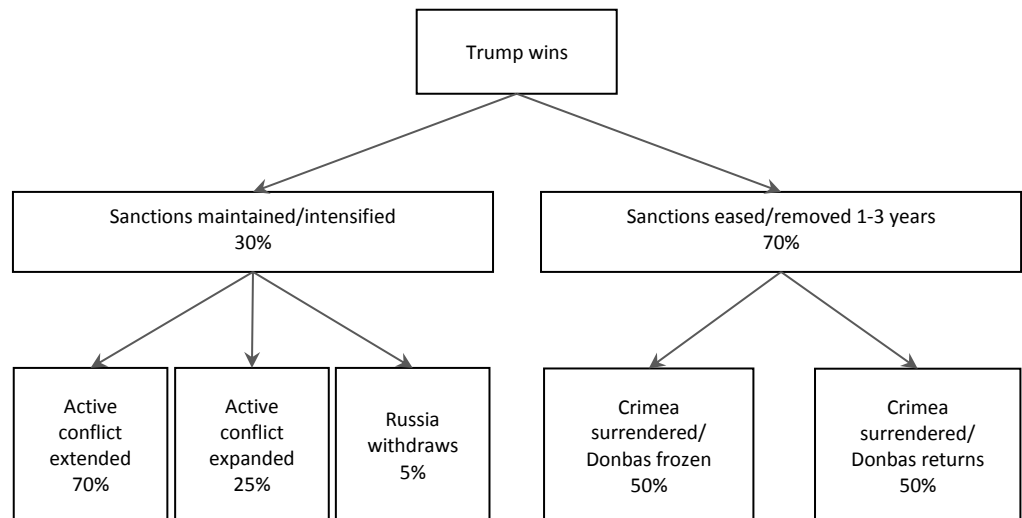
Reflecting the position of the Western political establishment, Clinton has shown no willingness to consider lifting sanctions related to the illegal annexation of Crimea or the ongoing military aggression in Donbas. **Meanwhile, Putin can't save face unless sanctions are lifted. So we see the current state of affairs as being the most likely scenario under a Clinton presidency.** That means daily shootings, producing a handful of casualties or injuries every week. That also means no progress under Minsk Two, with no other options for peace on the horizon. Meanwhile, Putin has shown that he could be able to withstand the sanctions beyond 2017, with the support of the majority of the Russian public.

2. Sanctions maintained/intensified, Russia expands conflict

There's always the chance that the Russian economy will start to crack and slowly disintegrate sooner than expected and wholly unanticipated. In which case, Putin will likely resort to an expansion of the war in Donbas in order to maintain his grip on power and keep his hierarchy in place. Domestically, the goals of such a war would be to distract the Russian public and to further feed the public's nostalgia for imperial greatness. Putin would target Ukraine first and foremost, aiming to install a puppet government in Kyiv, which could be accomplished with tactical bombings and elite forces. At the same time, he could also decide to occupy parts of southeastern Ukraine (the Kharkiv, Odesa and Dnipro regions), where a sizable minority (between a quarter to a third) will be loyal to his forces. Besides further dividing Ukraine, the goal of the occupation would be to remove or destroy valuable assets such as factories and domestic military bases.

Those who dismiss this possibility claim that not only is the Russian military capable of occupying a territory as large as Ukraine, but a civil war as chaotic as Syria could emerge between various Ukrainian oligarch clans and political factions. To this first claim, we argue that the occupation would be handled by using Ukrainians rather than the Russian military. And secondly, an essential component to the occupation would be exacerbating divisions among the many Ukrainian factions based on political and financial interests. For example, it would be a lot easier to install a puppet regime in Kyiv if there is warring in Kharkiv and Odesa. Historically, chaos in Ukraine has always worked to the Russians' advantage.

Trump Wins



1. Sanctions eased/removed, Crimea surrendered, Donbas returned to Ukraine

Despite vowing to meet with Putin as one of his first gestures as president-elect, Trump will not be able to ease or remove sanctions upon election by himself. But his election will most certainly set the tone for turning the global political tide in favor of removing sanctions against Russian and Ukrainian officials for the Crimean annexation.

If Trump maintains his popularity in the first term of his presidency, we can expect members of the Republican Party in the U.S. to begin to adopt more of his policies. We can also expect the French to join the nationalist-populist wave in the West when choosing their president in the spring, followed by the Germans in September when they elect their parliament (which then elects its chancellor).

As among his key options, we believe Trump will be willing to trade Crimea in exchange for returning Donbas to Ukraine, which will satisfy Putin fully. Since the failure of the Novorossiia project (which planned for all of southeastern Ukraine's regions successfully separating), Putin's plan has been to return a ruined Donbas back into Ukraine's fold. The Minsk Accords are part of that plan since they would give hostile Donbas residents the ability to influence Ukraine's parliament and Cabinet and further undermine any Euro-integration efforts.

In our view, fulfilling the Minsk Two Accords has just as much potential to destabilize Ukraine as sanctions forcing Russian economic collapse. Their fulfillment requires steps that are highly unpopular among the Ukrainian public, such as holding elections without restoring Ukrainian control of the border and amending the Constitution to create autonomy for Donbas. For more than a year, the West has been pressuring Ukraine to take the first step of organizing elections, but not forcing them whenever Ukrainian President Poroshenko has resisted. If Trump's foreign policy team works to impose the elections on Ukraine, and Poroshenko sees the need to follow through, that could be a trigger for large segments of the public to revolt, potentially in a violent manner. War veterans and nationalists have even threatened a revolt under such conditions.

2. Sanctions eased/removed, Crimea surrendered, Donbas conflict frozen

If Trump's foreign policy team is wise enough however, it can work to create what we view as the best viable option in a bad situation for Russia. That option is a frozen conflict, in which the active fighting ceases totally, soldiers are left to maintain their defensive positions and no political solution is reached, leaving the current status quo in which Russian-backed proxies continue to govern the Donetsk and Luhansk People's Republics (rather than attempting to restore Ukrainian government control).

A frozen conflict could be realistically achieved with the removal of sanctions related to Crimea, in exchange for the West extending its policy of turning to a blind eye to Poroshenko's refusal to fulfill the Minsk Accords. A frozen conflict would create peace lasting for at least three years and would allow relations to normalize between the West, Russia and Ukraine.

Critics argue that this atmosphere would create a situation in which pro-Russian forces could return to power in Ukraine. However, the demographics of Ukraine without Crimea and Donbas ensure that a Russian-oriented president will never return in Ukraine. And though the Russian-oriented force stands to make gains in parliament, we are also confident that it will never have the numbers to form a majority, particularly without Donbas and Crimea.

EU INTEGRATION

In this Western political arena, **the Russians have gained significant momentum this year in undermining Ukraine's EU integration.** The Dutch public voted in April to reject the Ukraine-EU Association Agreement, followed by the June Brexit that undermined Western unity in favor of isolationism. The next test of whether the anti-globalist wave will gain momentum will be the U.S. presidential election on Nov. 8.

The Ukraine-EU Association Agreement is stalled after an April referendum rejecting it in the Netherlands, which became the only EU member-state out of 28 to deny Ukraine's bid. The far-left and far-right manipulated the referendum as more of an opportunity to express dissatisfaction with EU policies rather than having anything to do with Ukrainian integration. **The agreement is now at a dead end since the EU leadership refuses to allow it to be amended,** especially after Dutch proposals at compromise merely echoed earlier Russian demands. Even Dutch politicians have acknowledged that they don't see a way out of the mess that was created. **What's more important, though, is its implementation has already begun and will continue as many of its requirements are shared by Western institutions.**

The launch of the Ukraine-EU Free Trade Area on Jan. 1 boosted trade slightly, **but more importantly, it has prompted Ukrainian producers to begin adopting EU safety and sanitary standards,** or at least seriously consider doing so. In particular, many Ukrainian meat producers still don't meet such standards but are seriously considering adopting them. In its effort to receive Western loans, especially from the IMF, the Ukrainian government has been pursuing reforms that coincide with EU standards and requirements, such as strengthening payment discipline at state-owned enterprises and requiring complete asset declarations by high-ranking officials. Many IMF requirements coincide with EU Association requirements.

WATCH LIST

- Nov. 8: U.S. presidential election
- Nov. 17- 18: Obama to visit Germany to discuss Syria, Ukraine with Merkel
- Nov. 24: Ukraine – EU Summit
- End-November: Strengthen anti-corruption bureau
- End-December:
 - Pension reform
 - Simplify privatization
 - Merge tax and customs administrations
- April-May 2017: French presidential elections
- September 2017: German Bundestag elections

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