

Open window before the storm

Ukraine considers painful steps on eve of turbulent election season

Ukraine | Politics

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September 21, 2017

Summary: last chance for reform before turbulent election season

Ukraine's parliament convened on Sept. 5, opening up a political window that will last about six months for the Ukrainian government to consider any painful or dramatic measures that will otherwise be avoided during the election campaign season that will intensify in spring 2018. On the domestic front, parliament will consider the IMF's requirements for the next loan tranche this fall, which is mainly a pension reform package that we expect will be approved this month. While it doesn't enjoy much support among the public, what's even more unpopular are natural gas price hikes – agreed upon by Ukraine with the IMF – that are scheduled for October. Ukrainian officials are currently negotiating to avoid them, which we think is possible as part of a compromise to secure the next loan tranche, which we expect to be achieved by the year end.

Regarding the **war in Donbas**, parliament is preparing legislation creating the legal framework to reintegrate the occupied Donbas region into Ukraine, as well as responding to Russia's hybrid warfare in a more pragmatic way that current laws don't allow for. The warfare continues to be waged at a low level, accounting for a handful of casualties and injuries every few weeks. Almost no territory has changed hands since February 2015, when the Minsk Two Accords were signed. Neither have they been upheld, earning them the reputation of being a failure (though they succeeded in halting the escalating warfare). In recent months, Ukrainian leaders have raised the possibility of gaining weapons from the U.S. government to defend against the Russian-backed attacks. We view this as highly unlikely. We expect Russian President Putin will use the warfare in Donbas in the run-up to the 2019 elections to affect public sentiment, in the hope that fear and moral exhaustion will boost support for Russian-oriented candidates.

Just as the West is intensifying its pressure on Russia to leave Donbas and return Crimea, **the Russian government is intensifying its hybrid war on Ukraine** on all fronts. Militarily, Russia has conducted joint military exercises with Belarus this month which Ukrainian President Petro Poroshenko described as preparations for full-scale war. Politically, Russia continues to nurture its ties to nationalist parties in the West. Culturally, Russia is exploiting Ukrainianization efforts – from both the Ukrainian government and grassroots – to stir civil strife. In the information sphere, Russian news broadcasts portray Ukraine as economically devastated, a colony of Western interests and hostile to ethnic minorities. Economically, Russia is continuing to build a bridge across the Kerch Strait between Crimea and Russia that will shut down much ship traffic to Ukraine's Azov Sea and hurt economic activity.

The 2019 presidential elections are tentatively scheduled for March, while the **parliamentary elections** are scheduled for October, based on the current rules that could be adjusted. The campaign season, which has practically begun but will intensify in spring 2018, will be very turbulent. In addition to intense competition between Ukrainian political parties, the Russian government is sure to plan severe destabilization efforts throughout 2018, if not outright warfare, as Poroshenko warned two weeks ago. We believe Poroshenko is on track to win re-election as president, though his party is unlikely to repeat its first-place result in the 2014 vote. We see the Russian-oriented parties as having solid chances for earning enough votes to form a parliamentary opposition, which will embolden Putin. We believe Putin will begin contemplating withdrawing from Donbas, or complying with the Minsk Accords, if Poroshenko wins re-election and a pro-Western majority emerges in parliament (without a significant Russian-oriented opposition, as is currently the case).

IMF requirements: pension reform expected this month

Fifth IMF loan tranche depends on two-three key measures. The agenda of Ukraine's parliament, which convened for the fall session on Sept. 5, will focus on legislation that is required by the IMF for its next loan tranche, which we expect to be in the range of USD 1 bln (as with the tranche released in April). We expect Ukraine will receive what would be its second IMF tranche this year and not doing so will be widely viewed as a disappointment. IMF First Deputy Managing Director David Lipton arrived on Sept. 13 for a meeting with the president, approving no progress towards reaching an agreement on the tranche. The IMF also declined to disclose the date of its next visit. So far, Ukraine has received USD 8.5 bln in five loan tranches from the IMF since agreeing to the USD 16.8 bln External Funds Facility (EFF) in March 2015 (USD 17.5 bln, based on then-exchange rate). A "tranche compromise" will be reached with Ukraine agreeing to fulfill two or three of the following points. Just what those points will be, and under what conditions, will depend on the political winds at that moment, which are shifting daily.

Point #1: Pension reform package. The most important legislation to approve will be the pension reform package, whose first reading was passed in mid-July. More than 2,100 amendments have been made since then. Despite the potential for gridlock – and more reviews from IMF officials if it's approved with the amendments– we expect parliament will approve the second reading this month, despite criticism (though virtually no public protests). Its most salient points are:

- Systemic recalculation of 5.6 million pensions (still based on 2007 wages), resulting in higher payments for 9 million Ukrainians;
- Pensions recalculated annually based on a standard of average wage and inflation indicators, beginning October;
- Gradually raising the minimum qualifying official employment tenure to 25 years during the next 10 years;
- Eliminating special categories for early retirement, except for law enforcement;
- Creating mandatory private pension accounts for those more than 10 years away from retiring;
- Eliminating the UAH 140 bln hryvnia pension deficit in 7-10 years.

Point #2: Natural gas price hike. In order to secure a loan tranche in May 2016, Ukrainian authorities agreed to base household natural gas prices on global market rates. Now that these prices have increased, they are currently negotiating with IMF officials to postpone this price hike scheduled for October by adopting an entirely different model (than EU gas hub price plus delivery cost to Ukraine). They even suggested setting prices locally. A price hike would be wildly more unpopular with voters than even the creation of the farmland market, which the authorities also don't want to deal with. We expect a compromise that preserves the "automatic formula," which Lipton indicated is essential.

Point #3: Consistent fiscal policy. Last week, IMF spokesman Gerry Rice called for fiscal policies "being consistent with commitments," likely meaning that the 2018 state budget deficit shouldn't exceed 2.5% of GDP. Indeed the 2018 budget draft has a 2.4% deficit.

Point #4: Financial crimes agency. The IMF wants the approval of a civil service agency within the Finance Ministry to investigate financial crimes against the state, which will replace the tax police that ceased its activity early this year. We don't expect the Poroshenko Bloc will approach such legislation with enthusiasm, but if the IMF's push comes to shove, the Presidential Administration should have little trouble mustering support.

IMF requirements: Poroshenko resisting independent court

Point #5: Independent anti-corruption court. We say “push comes to shove” because Poroshenko is currently resisting another key IMF demand of creating an independent Anti-Corruption Court to review the cases prepared by the National Anti-Corruption Bureau of Ukraine and Specialized Anti-Corruption Prosecutor’s Office. To the relief of Western authorities and the NGO community, these two agencies have demonstrated their independence and willingness to seriously pursue corruption cases. Since their creation in 2015 (as required by the IMF), they have drawn the criticism and resistance to its activity from the Poroshenko administration. The president reportedly convinced Jean-Claude Juncker, the EU president, to agree to allow the court to be created as “chambers” under existing judicial bodies, rather than as an independent court. Ukrainian media reported in mid-August that the IMF had yet to reach a final decision on the matter. This has prompted vocal protests from Artem Sytnyk, the bureau’s head who has been firmly backed by Ukraine’s NGO community in supporting an independent court. We expect public pressure – including authorities like former U.S. Secretary of State John Kerry who supports an independent court– will prompt the IMF to make it a requirement.

Point #6: Political repression amid corruption crackdown. Perhaps to compensate for its resistance to anti-corruption, authorities have engaged in some crackdowns, including the port city of Mykolayiv, where they arrested five alleged gangsters linked to the Russian-oriented Opposition Bloc. The party alleged political persecution. Indeed the Poroshenko administration has targeted political rivals, or at best “disposable” politicians, but never anyone of his entourage. The latest strike against the Opposition Bloc came last week when former justice minister Oleksandr Lavrynovych was arrested for alleged crimes in 2010. Meanwhile, key leaders in the Fatherland party – which has surpassed the Poroshenko Bloc in recent polls – had their property searched last week. These actions come after the “Lviv garbage conspiracy” against Mayor Andriy Sadovyi – in which the president is accused of deliberately preventing garbage from being removed from the city– and Mikheil Saakashvili having his citizenship stripped. Rather than impressing IMF officials, the government risks drawing a critical response from Western authorities, who have turned a blind eye so far.

Point #7: central bank appointment. President Petro Poroshenko has stalled in this regard since Valeria Gontareva first announced her resignation in April. He was comfortable with her since she had performed work for his enterprises. It will be interesting to see if he appoints another business associate and whether IMF officials accept it. Lipton also cited “continuing the banking system’s cleansing” as a requirement.

Point #8: Privatization. An IMF demand that the government worked hard to satisfy in August was the privatization of stakes in power generation and distribution companies. Five 25% stakes were auctioned last month, all of which were acquired by the SCM holding owned by Rinat Akhmetov, who holds the controlling stakes in these firms via DTEK Energy. The auctions raised UAH 3.05 billion for the state, which is more than what was raised in the last four years. Although IMF spokesman Gerry Rice called for “measures to speed up privatization” last week, these auctions likely satisfied the IMF, which didn’t specify its privatization recommendations beyond nitrogen fertilizer producer Odesa Portside Plant, power generator Centrengo, turbine manufacturer Turboatom and regional energy distributors. In his turn, David Lipton called for “improving the administration of state enterprises” as an IMF requirement during his Sept. 13 visit to Kyiv.

Point #9: Farmland market. A compromise was reached in another key IMF demand, the launch of the farmland market, which won’t be required for securing the next loan tranche as the Poroshenko administration convinced authorities that it would be too difficult and needs flexibility. At least two-thirds of the public oppose trading farmland, according to polls conducted this summer. We are confident that Poroshenko will try to postpone the market’s creation until after the elections, and we believe it’s possible the IMF will allow for that as part of the tranche compromise.

Non-IMF legislation in the pipeline

Already behind on EU Association legislation. Another priority for the parliament, as underlined by Deputy Speaker Iryna Gerashchenko of the Poroshenko Bloc on the eve of the fall session, is legislation required by the Ukraine-EU Association Agreement, which took effect fully on Sept. 1. Ukraine will have to fulfill an EU integration road map that consists of specific legislation that needs to be approved on a timetable. Yet Gerashchenko has already admitted that the government has fallen behind schedule, having yet to even begin identifying legislation and regulations that will need amending.

Education reforms approved, key appointments in the works. On its first day of work, parliament approved an education reform package, with plans to change the medical system. It will have to approve the nation's human rights ombudsman, which has been the subject of yet another political battle between the Presidential Administration and Ukraine's NGO community. Another certain battle in parliament is the appointment of members to the Central Election Commission, which is loyal to the president, who will want to keep it that way.

Reintegrating Donbas. Another key bill in the pipeline is the law on reintegrating Donbas, which is almost ready to be introduced in parliament, legislators said. Drafted with the involvement of U.S. and EU consultants, it creates the legal framework for a new military strategy to respond to Russia's hybrid warfare. It establishes a permanent military headquarters in the war zone with wide authority to direct the Armed Forces. The law also enables the government to employ the Armed Forces in conditions other than an officially declared war (which would close access to IMF loans) or the current anti-terrorist operation. For the first time, the legislation officially establishes that parts of the Donetsk and Luhansk regions are occupied by Russian forces, who are waging military aggression against the state of Ukraine and violating the Minsk Accords. It's for these components that the bill has drawn criticism, for making declarative statements.

The "Croatian scenario." We believe the legislation also creates the option for the Poroshenko administration to pursue a so-called "Croatian scenario" in Donbas, in which Ukraine's Armed Forces would mimic Croatia's success in retaking in 1995 its territory occupied by Serb forces. Ukrainian officials have increasingly discussed this scenario in recent months in the mass media. Indeed, driving the Russians out of Donbas before the 2019 elections would ensure the president's re-election and extend his control of parliament. Yet we don't expect Ukraine will have U.S. support for such an endeavor, partly because Ukraine's situation is starkly different than that of Croatia (the free Serbian-occupied regions didn't border Serbia, which was easier for Croatia to combat than Russia is for Ukraine). Some in Ukraine have speculated that a UN peacekeeping mission would set the stage for a Croatian scenario. Yet that's only one of the reasons why we expect Putin won't agree to a peacekeeping mission.

UN peacekeeping mission. The Donbas reintegration bill will also outline Ukraine's vision of an international peacekeeping mission, the Poroshenko Bloc said. Russian President Vladimir Putin has submitted his proposal for peacekeepers to the UN Security Council, while the Ukrainians will submit their proposal. Last week the U.S. said it will seriously consider sending UN peacekeepers to patrol the entire territory of occupied Donbas. We don't expect any agreement to be reached on a peacekeeping mission partly because Russia isn't interested, and partly because they won't be able to compromise even if it was interested. For instance, it's doubtful Russia – as a Security Council member – would approve a mission that doesn't involve its citizens. A peacekeeping presence would also limit Putin's ability to use the war to influence politics in Ukraine, which is the main purpose of his occupation of Donbas.

Donbas war and Minsk Accords

No peace achieved in Donbas. Though slipping below the headlines in the Western media, the war in Donbas continues to be waged at a low level, producing a handful of casualties and injuries every few weeks. No significant territory has been exchanged since the battle for the Debaltseve railway hub in February 2015. The signing of the Minsk Two agreement that month led to its conclusion, after which the Russians took control of the town. Intended to clarify the conditions for peace in the first draft, Minsk Two also failed, with both sides accusing each other of violations and failing to maintain a ceasefire for any extended period. However, they did succeed in halting the escalation in warfare.

Volker diplomatic attempt falls flat. The biggest diplomatic development this year in the Donbas conflict was the July appointment of Kurt Volker, the former U.S. representative to NATO, as the U.S. special representative to Ukraine. He immediately made clear that he intends to reach some kind of breakthrough in the ongoing conflict. The biggest attempt came at an Aug. 21 meeting in Minsk with his Russian counterpart, Vladislav Surkov, who is among Putin's key advisors on Donbas. The details of the meeting are limited to the general comments that both made afterwards. Surkov said it was "a good meeting" during which "both sides offered fresh ideas and innovative approaches towards their fulfillment." They agreed to continue their common work and determined topics for their next meeting, he said. In his turn, Volker didn't directly comment on the meeting, repeating in the following days the U.S. position that Russia must remove its soldiers and hardware from Donbas and that sanctions against Russia need to be maintained until it upholds the Minsk Accords. Volker revealed more in an interview published on Aug. 27 in the Financial Times, expressing disappointment in Russia's uncompromising position, stating that its leadership is trying to freeze the conflict in Donbas and warning that Russia will suffer further economically as more time passes under the sanctions. He called upon Russia to make a choice in reaching peace with the U.S. on Donbas, or further enduring sanctions and keep relations "limping." We don't expect Volker will accomplish any breakthrough in his tenure.

U.S. armaments under consideration. Top Ukrainian officials -- including National Security and Defense Council Secretary Oleksandr Turchynov and Parliamentary Speaker Andriy Parubiy -- have repeated numerous times that they were assured by U.S. officials this summer that extending lethal defensive weapons to the Ukrainian army is under serious consideration. (It's not clear whether that would occur in the form of a sale, loan or grant.) When attending Ukraine's Independence Day commemorations in late August, U.S. Defense Secretary James Mattis confirmed these claims, going further by stating that he "will inform U.S. leaders on 'very concrete things' that I will recommend." In the three years that the proposal of the U.S. offering lethal weapons to Ukraine has been discussed, we have consistently maintained our expectation that lethal defensive weapons would not be offered. The U.S. military leadership knows well that getting deeper involved in this conflict would not only further worsen U.S. relations with Russia, but also exacerbate the fighting on the ground and potentially expand the warfare geographically. We are confident that the geopolitical forces currently involved -- Russia, the U.S. and the EU -- are more-or-less satisfied with the conflict's current low level status. Even the Poroshenko administration is taking advantage of the situation to use authoritarian tactics to entrench itself in power. Meanwhile, if the decision is up to U.S. President Trump, as indicated by Volker in his ft.com interview, then he won't escalate the conflict against Putin, whom he doesn't consider to be a significant geopolitical threat.

Russia strategy in conquering Ukraine

Russia's hybrid warfare. If a new peace agreement is to emerge on Donbas, it will need to involve reaching a compromise on Crimea. That could involve relaxing sanctions imposed for its illegal annexation, or creating a stalemate by declaring it to be an unresolved territorial dispute (what German nationalist Christian Lindner referred to as “sealing” the conflict). Though Western governments have maintained a firm position against any relaxing of sanctions (with the EU extending them for another half-year on Sept. 6), we believe EU member-states could start to grow impatient from all the lost trade by next year, which will be compounded if nationalist parties make more gains, as is likely in Germany. We believe this expectation of EU fatigue is part of what's motivating Putin to withstand the pressure from the sanctions.

New Eurobonds rescue economy. Putin is also motivated by a greater goal of returning the Ukrainian territory – whether as a unitary, federalized or disintegrated state – within Russia's sphere of control. We believe Putin will extend the warfare in Donbas – and the overall aggression against Ukraine – until he achieves control of Ukraine, or until economic sanctions begin to threaten his rule, whichever comes first. In this war of attrition between Russia and Ukraine, it's a question of which economy will collapse first, with Putin being confident that it will be Ukraine's. However Ukraine won a major battle this week with its Eurobond placement. The country avoided a potential default on steep debt repayments by USD 1.58 bln in 2019-20 via successfully placing Eurobonds this week, reducing sovereign debt repayments to a more affordable USD 9.5 bln in 2018-20. So Western support has succeeded in preventing Russian pressure from collapsing the Ukrainian economy. It has yet to be seen whether Putin will attempt a veiled surrender when his economy starts to collapse, or if he does something even more drastic by expanding the war.

Military aggression. Fire is exchanged daily along the Donbas frontlines. Meanwhile, the Security Service of Ukraine has urged Russia to refrain from its sabotage activity within Ukraine's borders, such as foiled assassination plots and land mine plantings this summer. The Zapad 2017 joint military exercise involving Russian and Belarusian armed forces has raised the concern of NATO officials, who said that the hardware could be left in Belarus to use for invading neighboring countries. Addressing parliament, Poroshenko stated bluntly that such military exercises are evidence Russia is “preparing for an offensive war on a continental scale that is growing further.” We don't expect Russia to launch any widescale war in the next two years.

Political aggression. Russia continues to recruit the support of nationalist forces in the West. Most recently, the Alternative for Germany – likely to gain seats for the first time in the Bundestag in the September elections – proposed “sealing” the territorial dispute over Crimea until progress was made on other issues. Meanwhile, the Russian media, including the English-language Russia Today, exploit negative information about Ukraine. It didn't help when a Washington armaments expert reported that North Korea's recent success in testing ICBM missiles was made possible by black market purchases of rocket engines that likely came from Ukraine, in particular the struggling Pivdenmash armaments plant in Dnipro. We believe Russia will have more success on the politically as the West gets exhausted from the conflict and lost trade, and nationalist parties make more gains.

Economic aggression. Russian media have highlighted worsening industry caused by the trade war, such as Pivdenmash losing valuable purchases from Russian clients. Such reports are aimed at convincing Ukrainians of the futility of resisting Russian influence. Meanwhile, the construction of the bridge across the Kerch Strait connecting Crimea with Russia – projected by the Russian Transport Ministry to be open to traffic next year -- will restrict ship traffic in the Black and Azov seas, reduce economic activity at ports, and cause socio-economic risks of stagnation in the Azov region, according to a Kyiv military think tank. We believe this war will leave both the Russian and Ukrainian economies devastated when the smoke clears.

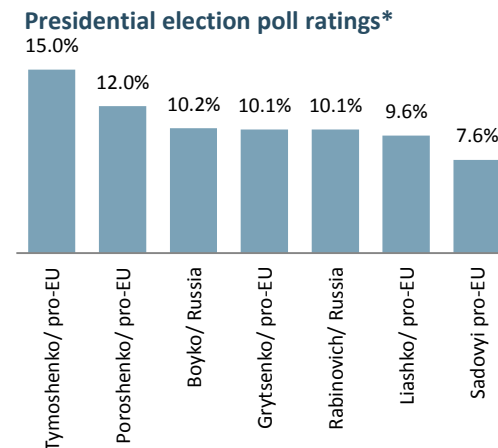
2019 presidential elections: Poroshenko on path to re-election

Presidential race: Tymoshenko is the leading current challenger. The presidential elections are scheduled for March 2019, though the date might shift by several months. Poroshenko will face off against an opponent that is not clear at the moment, but polls currently identify his top rival as former Prime Minister Yulia Tymoshenko, who was famously imprisoned by former President Yanukovich for 28 months before being freed by the EuroMaidan revolt in February 2014. Tymoshenko will likely position herself as a pro-Western populist who will improve economic conditions for the public. While a possible political gambit would be to take an appeasement position towards Russia and appeal to southeastern votes (who have the most negative view of Poroshenko), we don't see Tymoshenko as being capable of doing so. Indeed Tymoshenko has flirted (politically, that is) with Russian President Putin in the past, most notably during the 2009 talks to renew Ukraine's natural gas contracts. During the talks, Tymoshenko joined Putin in belittling Ukraine's president at the time. It's also worth remembering that in her 2010 presidential campaign, Tymoshenko tried to appeal to southeastern Ukrainian voters, despite being the pro-Western candidate. It didn't work then and it won't now since southeastern Ukrainians still associate her too closely with the Orange and EuroMaidan revolts and don't view her as one of their own (despite being a native of Dnipro herself).

The pro-Russian threat. Another obvious challenger to Poroshenko would be the current head of the Opposition Bloc, Yuriy Boyko. The Opposition Bloc is the successor to the Party of Regions, the Russian-oriented party led by former President Yanukovich that disintegrated following the EuroMaidan. The party hasn't softened its position that favors tighter integration with the Russian economy and defending Russian cultural rights. Its politicians have also advocated for peace and compromise in the current war. However, the party is performing weakly in the polls, not even able to muster much support from its base in the Southeast. Meanwhile, party head Boyko utterly lacks charisma, an energetic presence, or photogenic qualities. He is closely associated with the post-Soviet oligarchy, which would eliminate his support among the under-40 crowd.

A wide open field amid low poll numbers. Yet in an election field in which Tymoshenko and Poroshenko are drawing only 11.2% and 9.5% support respectively, a new challenger could come out of nowhere and easily become the public favorite (similar to the surprising performances of Donald Trump and Emmanuel Macron). It's for this very reason that we believe Poroshenko organized the "Lviv garbage conspiracy" to undermine the credibility of Mayor Andriy Sadovyi. Though Mikheil Saakashvili can't run for president or parliament, he is a strong organizer and effective communicator for the pro-Western opposition, which we believe prompted Poroshenko to arrange for his citizenship to be deprived. Poroshenko has not made any similar moves against Tymoshenko simply because she already has worldwide recognition for being unfairly treated by the previous president. But key officials of the Fatherland party had their property searched last week in what we view as political repressions. A potential wild card candidate is pop star Svyatoslav Vakarchuk, who is reported to have earned as much as 12% support in some polls.

Election is Poroshenko's to lose. Unless this surprise candidate emerges and overall conditions generally remain the same, we see Poroshenko easily defeating Tymoshenko in a second-round runoff. As unpopular as Poroshenko is, he has introduced a certain mediocre stability in a time of war that appeals to a certain segment of the public. On the other hand, Tymoshenko is a polarizing candidate who is widely viewed as someone who could bring more chaos to the situation. Of all the current candidates, we don't see anyone capable of earning enough public trust to defeat Poroshenko.



2019 parliamentary elections: Putin looking for gains in the Rada

Solidarity party not as popular as its leader. It's a very different scenario regarding the elections for Ukraine's parliament, the Rada, which are scheduled for October (but could shift by a few months). We see the Poroshenko brand as having more potential in the presidential elections than at the parliamentary level, where his party is likely to compete as the Solidarity Poroshenko Bloc. Few MPs of this party have made a name for themselves and Solidarity has no association in the minds of voters other than being the party led by the president. As a result, it has only 9.3% support, according to a July poll. Remarkably, that's second place, behind Tymoshenko's Fatherland party at 11.2%. These polls ratings will change dramatically in the coming months with the Russians working hard to boost parties oriented towards the Kremlin.

Russian-oriented parties gaining. Unlike Solidarity, we see the Opposition Bloc as drawing more public support than its leader Boyko is capable of attracting. Its predecessor, the Party of Regions, consistently drew the most support in the eight southeastern regions. If its work is organized properly with a clear and captivating message, it has the potential to recapture its electorate (which was scattered in the 2014 elections). Other parties are also emerging to collect the shards of the shattered Russian-oriented electorate, which we believe has the potential to become the main opposition to Poroshenko in the next parliament, as opposed to the current pro-Western opposition that has been focused more on socio-economic campaigns, such as protesting IMF-required gas price hikes and opposing the farmland market. We believe the Russian-oriented parties – consisting of the Opposition Bloc, the For Life party and possibly others – will be capable of cobbling together an opposition of at least 20% of MPs. Depending on what happens with the war and socio-economic conditions, the Russian-oriented forces could earn enough support to form the majority, though we see that as unlikely.

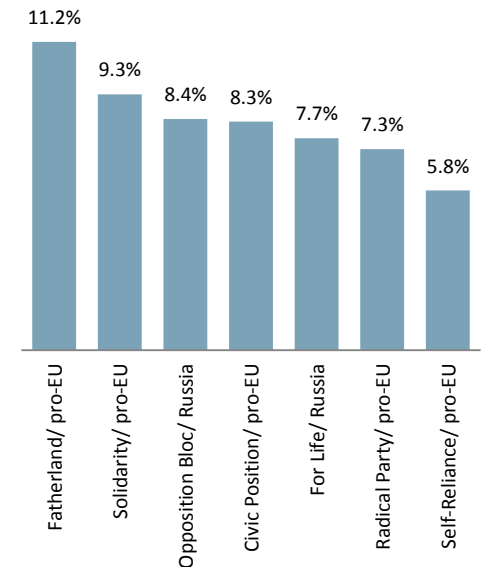
Poroshenko to keep mixed election system. Poroshenko is likely to ignore calls from NGOs and the general public for introducing a proportional, open-list voting system, instead keeping his hybrid system of half of MPs elected by single-mandate districts, the other half elected by closed-list voting. This enables him to assemble situational majorities by striking deals with single-mandate MPs for their support on individual items of legislation.

The most likely election scenario is that Poroshenko wins re-election and is able to form the parliamentary coalition with other pro-Western parties, promising to execute the reforms that were ignored in his first term. He will be able to cobble together the support of single-mandate MPs in case the coalition doesn't provide enough votes. We view with equal likelihood that either a pro-EU or Russian-oriented parliamentary opposition emerges. The latter would suit Poroshenko just fine (also emboldening Putin), while a reform-oriented, pro-EU opposition poses a bigger threat to his rule and its alleged corruption.

We see these other scenarios as being equally unlikely, but possible:

- **Elections disrupted due to warfare.** The war in Donbas can escalate to the extent of disrupting the elections, most likely because the Russian government anticipates losses. However, that is unlikely given we see only gains to be made by the Russian-oriented parties.
- **Poroshenko wins, Russian-oriented parliamentary majority.** Unlikely but possible, especially if socio-economic conditions worsen amid an intensifying war, which will further exhaust and demoralize the Ukrainian public.
- **Tymoshenko becomes president.** Unlikely, but possible if she's able to put together a well-organized campaign with relevant themes.
- **Russian-oriented candidate becomes president.** This is possible only if a candidate emerges besides Yuriy Boyko, who has no charisma.

Parliamentary election poll ratings*



Most likely scenarios for Ukraine: short, mid- and long term

What to expect with Donbas. At minimum, Putin needs a Russian-oriented parliamentary opposition to emerge from the 2019 elections. Without this, we believe he will face pressure from within the Russian elites to find a way to withdraw from Donbas and relieve Western economic and travel sanctions, which will have been in place for five years by then. The most likely means of this withdrawal would be the fulfillment of the Minsk Accords, though another option is the introduction of UN peacekeepers. Putin will be emboldened in his aggressive foreign policy if a Russian-oriented parliamentary opposition, but especially a majority, emerges to challenge Poroshenko.

What to expect with Crimea. In any case, we don't see Putin ever reversing his illegal annexation of Crimea. We see that as possible only with his eventual successor, in the event that he wants to re-engage the West. As for the U.S. and EU, we believe they would be willing to look the other way on the Crimean annexation, and even possibly relax sanctions, in the event of a combination of at least three factors developing in the next two years, as presented in the right-hand table.

Here are our scenarios for Ukraine in the short term (six months):

- **Current situation extended (likely):** low-level warfare in Donbas, Russian aggression maintained, sluggish economic growth. We believe all sides are more-or-less satisfied with the current scenario, especially Putin. Introducing U.S. weapons would disrupt this balance that has been achieved, which is why we are confident the U.S. won't support it, particularly President Trump.
- **Current situation aggravated (less likely):** Donbas warfare escalated, Russian aggression escalated, sluggish economic growth. This will happen if the current balance, which has been maintained since February 2015, is disrupted by one of the sides in the conflict.

Here are our scenarios for Ukraine in the mid-term (six months to two years):

- **Russia intensifies aggression to boost Russian-oriented candidates in Ukraine (more likely)** Generating fear and moral exhaustion among the Ukrainian public is likely to encourage voters, particularly in the southeastern regions, to select candidates that will appease Russia and seek peace, even at painful costs.
- **Russia extends low-level warfare, current aggression levels (more likely)** In his hybrid war, Putin can adjust the level of aggression to suit his needs on the diplomatic or political level. If he sees that Russian-oriented candidates are polling well, he might tone things down for their success.
- **Russia expands war, postponing elections (less likely)** Anything is possible with Putin. If he sees sure defeat on the horizon in the 2019 elections, he could just as well expand the warfare to disrupt them. This also applies if the West decides to involve itself deeper by sending arms or peacekeepers, which we don't expect.
- **Poroshenko attempts Croatian scenario, with U.S. backing (less likely).** This is a fantasy scenario for Poroshenko and his entourage that would ensure his re-election, but we don't believe the U.S. has enough confidence in the Ukrainian military to back such an effort.

Factors to change in West's Crimea policy of sanctions		
High likelihood (better than even)	Medium likelihood (about 50%)	Low likelihood
Putin maintains strong support from Russian public, including Crimea	Russia-oriented parties form opposition in Ukraine parliament	Russia-oriented parties form majority in Ukraine parliament
Nationalist parties make bigger gains in EU elections	EU corporations further pressure governments for compromise	Trump solidifies voting bloc in U.S. Congress

Putin or the West could back down, depending on 2019 results

Here are our scenarios for Ukraine in the long term (more than two years):

Outcomes with more likelihood

Poroshenko re-elected, secures parliamentary majority with no strong opposition, Putin begins to withdraw: The way events are currently unfolding, this is the most likely scenario. Therefore, we expect Putin to undermine this scenario and give a boost to Russian-oriented candidates in the elections, possibly (but not necessarily) with intensified military aggression in Donbas to prompt exhaustion and demoralize the public. The Russians are certain to invest much media coverage and other resources to Russian-oriented parties.

Poroshenko re-elected, strong Russian-oriented opposition, Russia stays in Donbas: The presidential election is Poroshenko's to lose, at this point. But we believe Russian-oriented parties have a strong chance to earn at least 20% of the vote and form the parliamentary opposition. They have about 16.1% support currently, which translates into a similar amount of seats based on the current hybrid election system (not knowing who will be elected by the single-mandate districts).

Outcomes with less likelihood

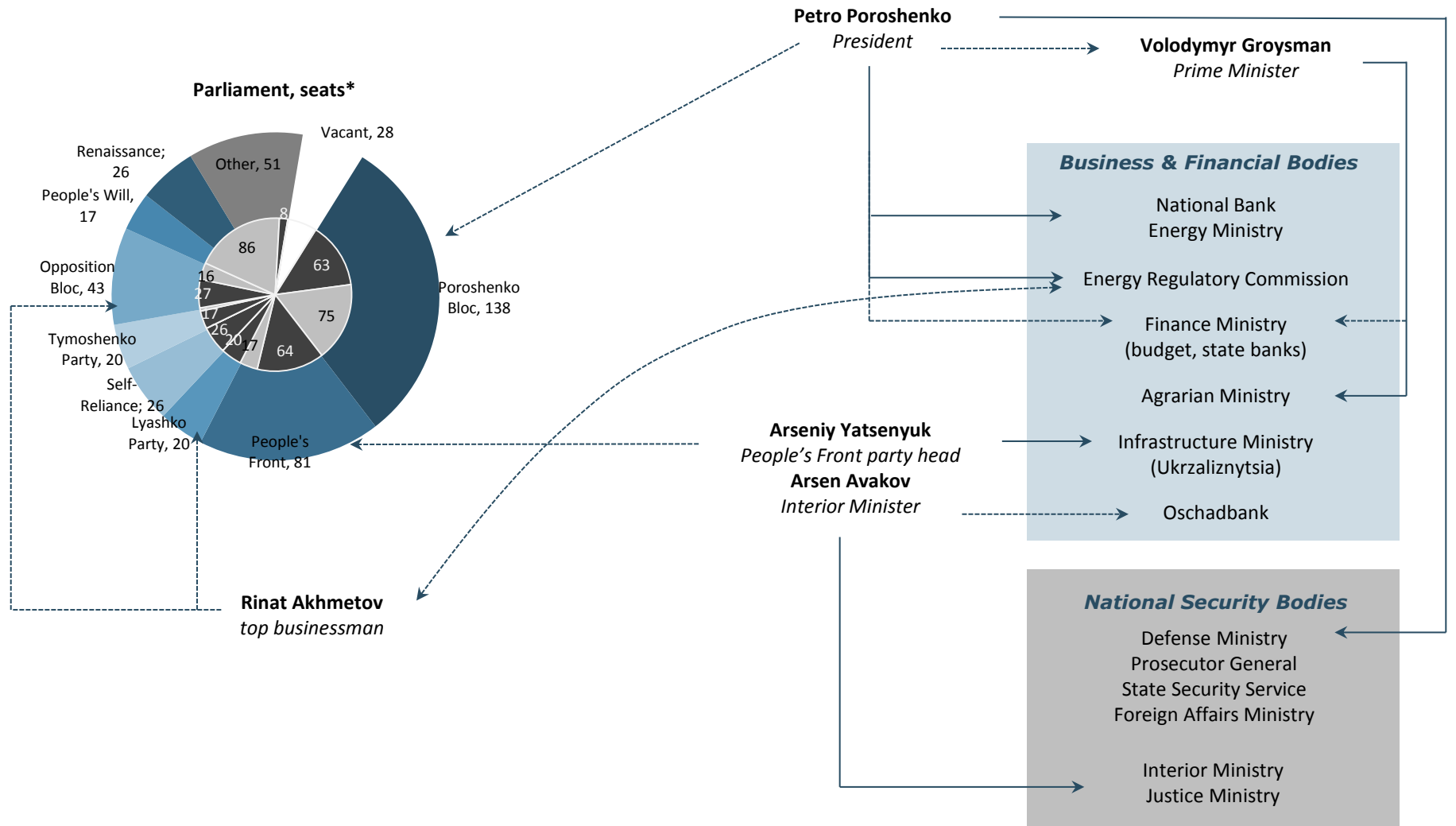
War expands, disrupting elections: If Putin learns months ahead that his allies won't have a significant presence in parliament, he could decide to expand the warfare anticipating certain defeat. We believe this is unlikely because the Russian-oriented forces are already polling well, and their support is certain to grow during the campaign.

Poroshenko re-elected, Russian-oriented parliamentary majority, West backs down: It's unlikely that the Russian-oriented forces will earn votes to form the parliamentary majority. But it's certainly possible considering a Russian-oriented majority emerged in 2006, even after the Party of Regions was found to have falsified the 2004 election results, prompting the Orange revolt. At this point, the West will have to reconsider its sanctions against Russia, with EU corporations eager to renew business.

Russian-oriented president elected: It's unlikely, but anything is possible considering Viktor Yanukovich was elected president in 2010 after he was proven to have engaged in falsifying the 2004 elections. This is only possible if a new candidate emerges because Yuriy Boyko, the current head of the Opposition Bloc, doesn't have the charisma to draw much support.

Tymoshenko or wild card president emerges: It's unlikely, but the field is wide open given the low poll ratings for any of the current candidates. A charismatic personality could emerge from the shadows to seize the elections. Someone like Vakarchuk could be a pleasant surprise, being unshackled in his ability to press for reforms that are so desperately needed.

Who's in charge in Ukraine



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