

UKRAINE

Winning the War is the Only Way Out

Ukraine's future now depends upon a rapid resolution to the military conflict with Russia. The situation is still very dicey, but at least three developments suggest Ukraine is well positioned to win. First, the separatists continue to lose support in the region, due to their blatantly cynical behavior (bombarding residential areas with mortar rounds, and forcefully drafting local residents into their ranks). Second, the authorities have finally determined their plan of action, which has won the broad support of society (measures include encircling the conflict hotspots with Ukrainian armed forces, and closing and strengthening the border with Russia). Finally, even if there's a full-fledged Russian intervention, we don't see how Moscow can win. The Kremlin has enough capacity to unleash a successful attack, but won't be able to control any captured territory for long, making it strategically foolish for Putin to raise the stakes. So a quick and decisive mopping up campaign in the east is a major assumption in our projections.

Barring more intensive military action, the economic situation looks better than expected. In particular, Q1 2014 GDP declined only 1.1%, instead of the initially estimated 3.9% y/y. By midyear, the drop will certainly be more extensive, due to budget cuts, investment decline and shrinking private consumption. But, due to improving external accounts, the GDP decline will be modest. In particular>>>

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