Ukraine- Forschungsgruppe at IOS in cooperation with IER Kiev:
Spotlight Ukraine: Monthly Economic Monitor March 2014

- **Government.** On February 22, the Parliament ousted President Viktor Yanukovych, who held his post for almost four years. That happened after a series of fierce clashes between the police and protesters, who demanded resignation of the President and strict law enforcement. On February 18 to 20, about 100 people were killed in the clashes in Kyiv. Such heavy casualties provoked a split in the ruling party and demoralized law enforcement troops, which started to go out of control of Viktor Yanukovych. As a result, he fled Kyiv, later he left Ukraine and found shelter in Russia. On February 22, the Parliament voted for a return to the Constitution of 2004, pushing the balance of power in favor of a parliamentary system. Oleksandr Turchynov, the first deputy leader of the opposition Batkivshchyna party, was appointed Speaker of the Parliament and, thus, became acting President of Ukraine. The Parliament also scheduled Presidential election on May 25. On February 27, it appointed Arseniy Yatsenyuk, the deputy leader of the Batkivshchyna party, as a Prime Minister, and appointed a new government. New Cabinet of Ministers intends to sign the Association Agreement with the European Union in the coming weeks, and resume negotiations with the IMF. To ensure new IMF program the Government plans to increase gas tariffs and sequester the budget.
- **Russia.** On February 27, Russian troops invaded Crimea, a peninsula in the South of Ukraine. The intervention was carried out without a single shot and was de facto supported by some members of Crimea's local parliament. On March 1, the upper house of the Russian Parliament authorized military intervention in Ukraine, claiming that Russian citizens and Russian speaking people in the country are under threat after the change of the Government of Ukraine. Ukrainian army and border guard did not try to stop Russian troops, presumably because Ukrainian government did not want to trigger a large-scale military conflict with Russia. The government qualified the intervention as an act of aggression, demanded that Russian forces withdraw immediately from Crimea and called for help to the USA and the EU. However, Russia officially did not recognize presence of its troops in Ukraine calling the armed men that invaded into the Crimea "local self-defense". The government of Ukraine continues to control its military bases and border control points in Crimea, but they are blocked by Russian servicemen. It is possible that the intervention of Russia to Crimea was a part of a larger plan that was aimed at seizing control over the whole territory of Ukraine. In late February Russian troops started massive training near the northwestern border, which is 250-350 km from Kyiv. Those military activities were stopped after the USA and the EU countries warned Russia about tough sanctions for aggression. But Russia in fact declines to withdraw its troops from Crimea. Moreover, on March 6, Crimea's local parliament suddenly voted in favor of joining Russia and scheduled a referendum on March 16 to confirm that decision. 78 out of 100 members of the parliament voted for the respective decree. The attempts to solve the conflict by diplomatic means were unsuccessful. It is likely that Crimea will remain under Russian control at least in the coming months. Russia may annex the peninsula and make it an integral part of its territory. Russia also may keep Crimea under control without annexing it (either as an autonomous region within Ukraine or an independent state with limited recognition) to get a lever of pressure on Ukraine after the change of government in Kyiv. The possibility of a large scale invasion into the mainland of Ukraine also cannot be ruled out. The conflict will have important implications on the economy. On the one hand, companies face increased political and security risks. On the other hand, the conflict helped Ukraine to get more financial aid from Western countries.
- **Industrial output declines.** Industrial output in January declined by 5% yoy from already low base of January 2013. In particular, manufacturing output dropped by 9.4% yoy likely due to lower demand as well as high political and economic

uncertainty. Production of metallurgy declined by 10.1% yoy. Machine building output contracted by 22.9% yoy primarily due to crash in production of locomotives and railway carriages (by 56.3% yoy) and production of electronic and optical products (by 59.3% yoy). At the same time, production of cars more than tripled from the extremely low base but dropped by a quarter as compared to January 2012. Food production declined by 4.9% yoy. As Odessa oil refinery started working since September 30, oil refining increased output by 76.2% yoy. Agricultural production in January increased by 6.0% yoy primarily due to higher production of meat and eggs. This was supported by increase in rearing pigs and poultry. Construction dropped by 16.4% yoy as investment spending suffered from political and economic instability. It should be noted that construction volumes are always minimal in January. Retail trade turnover in January grew by 8.8% yoy likely due to higher disposable income and decrease in savings rate. Lower confidence in banking system and depreciation expectations may explain decrease in propensity to save.

- **Energy: The Naftogaz might lose the gas price discount.** Russian Gasprom confirmed that Ukrainian Nafrogaz paid USD 1.3 bn for gas consumed in 2013 reducing its debt before Gazprom to USD 1.5 bn. However, this payment is not enough to extend the discount for the price of gas to the second quarter of 2014. Fearing the raise in gas price, the Naftogaz doubled its daily gas purchase volumes from 28 m cubic meters in February to 45 m in the beginning of March. That way the Naftogaz tries to accumulate more gas at a lower price. Correspondingly, the Naftogaz decreased outtake of gas from the underground storage facilities where Ukraine stored 9.2 bcm of gas as of beginning of March. Günther Oettinger, European Commissioner for Energy, said on March 4 that the issue of a huge Ukrainian debt would be included into the EC assistance package. Also, German RWE confirmed that according to the existing contract with the Naftogaz the RWE could increase gas supplies to Ukraine in case Russia decreases its gas export volumes to Ukraine.

Ukraine: Economic Indicators 2011 - 2014

		2010	2011	2012	Q2 13	Q3 13	Q4 13	Dec	Jan	Feb
GDP (real)	% yoy	4.1	5.2	0.2	-1.3	-1.3				
Industrial production (real)	% yoy cum.	11.2	7.3	-1.8	-5.3	-5.2	-4.7	-4.7	-5.0	
Agricultural prod. (real)	% yoy cum.	-1.0	17.5	-4.5	15.4	3.0	13.7	13.7	6.0	
CPI	% yoy eop	9.1	4.6	-0.2	-0.1	-0.5	-0.8	0.5	0.5	1.2
Current account	% GDP. cum.	-1.7	-5.6	-9.0	-4.5	-10.7				
Fiscal balance	% GDP	-6.0	-1.8	-3.6	-6.4	3.6				
External state debt (total)	% GDP eop	25.6	22.8	22.0						
Gross international reserves	USD bn cum.	36.7	31.8	31.4	23.2	21.6	20.4	20.4	17.8	15.5
Exchange rate (official)	EUR aop	10.53	11.09	10.27	10.44	10.58	10.87	10.94	10.92	11.80

Source: IER.

For further information: Institute for Economic Research and Policy Consulting (link: http://www.ier.com.ua).