

Global economic consequences of the Malaysian MH17 crash still to come

The crash of Malaysian Airlines MH 17 in Ukraine, beyond the all too human tragedy, has also raised market risks worldwide especially as far as the energy and banking sectors are concerned. Stocks dropped some 2-3% in worldwide trading on the day of the crash, July 17, only to recover – somewhat cynically – on the next day; however, as might have been expected, the Russian markets reacted differently. The Ruble dropped 5% and stocks some 2%. Meanwhile, the conditions for improvement do not exist. The crash of MH 17, regardless of who is ultimately found responsible, has only served to increase tensions. Even if the crash may offer Russian President Vladimir Putin reasons to reduce Russian support for the separatist rebels, the crash has only served to emphasize the deep differences that exist between the pro and anti Russian populations in Ukraine. This means the war in Ukraine has become even more intense. The crash has done nothing to resolve the underlying reasons for the conflict, adding only more motives to deepen them. Russian companies and Western ones that have business with them will have some difficult days ahead. Gazprom is the largest Russian company and the biggest extractor of natural gas in the world and Chinese demand may not be enough to protect it from potential new sanctions.

The US announced more sanctions against Russia on the very day of the MH 17 crash. Those will certainly deepen if it turns out that the missile that hit MH17 was, in fact, launched by pro-Russian separatists using Russian supplied weapons (even if the government forces have the same equipment). In that case, the U.S. and Europe would be forced to expand sanctions against Moscow, affecting such companies as the oil giant

Rosneft, which owns sizeable portions of important European companies like the tire maker Pirelli. Gazprom, Gazprombank, the principal shareholder of the South Stream pipeline would also be blacklisted. For its part, in the event of additional sanctions, and given that Russia has more than a 'few dogs in the Ukraine fight', Putin will not hesitate to retaliate with no less harsh measures. For the time being, the Kremlin has advised the White House that "the door remains open to negotiations to get out of this situation. But if our partners will continue with sanctions, measures will be taken against persons and foreign companies."

Moscow has an agreement with Beijing to supply gas worth up to USD\$ 300 billion over the next 30 years; however, the Russian economy, over the past two decades – and ironically especially in the 15 years of Putin's leadership, Russia has become well integrated in the Western economic system, more than Washington, Berlin or Moscow would care to admit. Russians have invested heavily in the West, as much as USD\$ 230 billion in foreign investments. Some companies rely on Western financial institutions and because of US sanctions, such companies will not be able to re-negotiate refinancing or other mechanisms, meaning that they will incur more interest on their loans, damaging the entire Russian economy. One of the first to suffer will be Rosneft itself. Then there is the issue of oil and interdependence with Europe.

Russia addresses half of European oil demand using about a third of its production (10.51 million barrels), collecting some USD\$ 160 billion a year at current prices. Even if it switches some of this oil in China's direction, facing more sanctions, it would not be able to secure the same prices. Moreover, Russia relies on Western companies to obtain most of the oil and gas industry hardware. Then again, many European companies are not eager to see more sanctions pouring on Russia. Western European companies deliver goods and services to Russia in the tens of billions. Some companies like United

Technologies, FIAT Autos, GM or even BMW have joint ventures in Russia not to mention energy sector companies like ENI – a South Stream partner. Italy and Germany would be among the greatest ‘losers’ in this situation. Former German chancellor Gerhard Schröder is at the head of the supervisory board of the North Stream gas pipeline. Without Russian gas, the industrial region of the Rhine valley may well come to a stop. The Ukraine crisis presents diplomatic challenges on both sides of the former ‘Iron Curtain’, are the leaders prepares to manage it?