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# ECONOMIC SITUATION AND STRATEGY

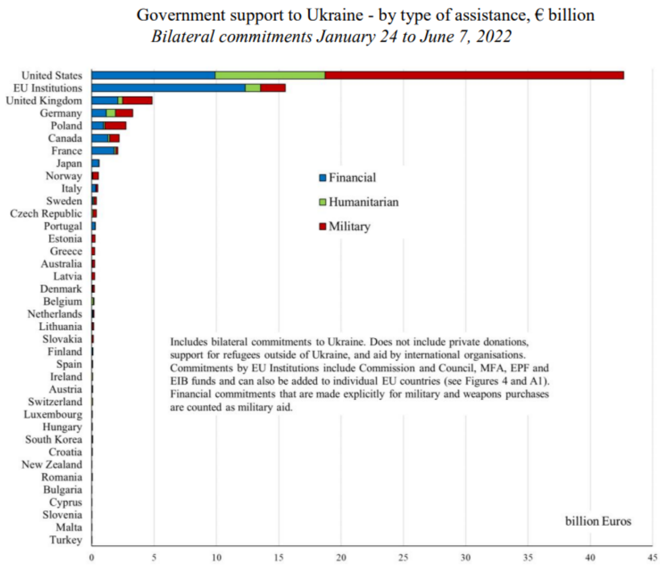
29 September 2022

## How effective are Western sanctions against Russia?

In recent weeks and months, the effects of Western sanctions on Russia have been increasingly called into question. The discussion has been fueled in particular by rapidly rising energy prices, with not only gas but also electricity now affected by historic price increases. By contrast, the sanctions appear to be having little or only a very slow impact on the Russian economy. Therefore, the question arises to what extent Western sanctions are suitable to actually achieve the goals pursued and whether they can contribute to an early end of the war.

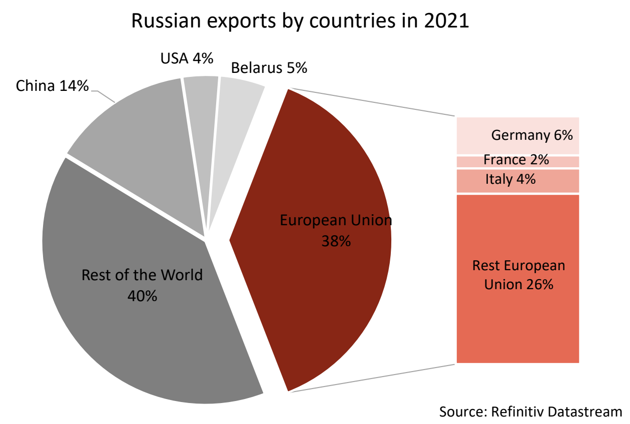
Since the beginning of the war, the European Union has adopted seven sanctions packages aimed at limiting Russia's economic options to such an extent that it will be impossible to continue the war against Ukraine in the long term. To this end, in addition to explicit military support for Ukraine by the West, the Kremlin's war funding is to be massively impaired. At the same time, very high economic and political costs are to be imposed unequivocally on the Russian political elite responsible for the invasion. The scope of the sanctions is "unprecedented," as Olaf Scholz asserted in his turn-of-the-century speech. Accordingly, the consequences for the Russian and European economies are immense.

Estimating the economic consequences for Russia, however, is a challenge. Since the outbreak of the war, there are no longer any current figures for many economic indicators from Russia. In addition, it should be noted that many data from Russia are likely to be embellished or deliberately show only sections of reality and obscure important findings from the surveys.



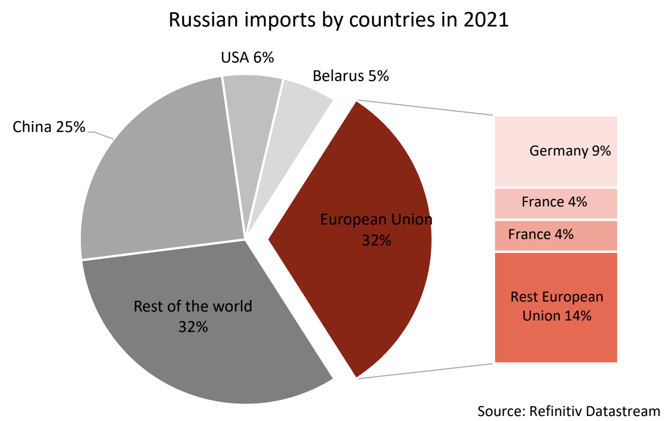

*Source: Antezza et al. (2022) Kiel Working Paper "The Ukraine Support Tracker"*

The main framework conditions nevertheless appear to be unfavorable for the national economy. Russia's economy is very dependent on Europe, especially for the sale of raw materials. Increasingly, Russia is trying to push its trade with China and India, but this is not possible everywhere or is significantly less profitable than trade with Europe. For gas, for example, a pipeline infrastructure is needed that so far exists between Russia and China at best in rudimentary form. The most significant pipeline between Russia and China ("Power of Siberia 1") was built in 2014, when Russia was already trying to develop new trading partnerships in East Asia in the wake of the Crimea crisis and the sanctions imposed at the time. Although "Power of Siberia 2" is being planned as another gas pipeline between Russia and China, it is not expected to be operational until 2030.




Last but not least, China is aware of Russia's difficult strategic situation and has been able to acquire the raw materials it has been importing from Russia since the start of the war at a much lower cost than was previously the case for Europe. For a barrel of its oil, for example, Russia had to waive a discount of around $35. In the long term, such currency declines are unlikely to fail to have their effects on the Russian economy.

Other indicators also point to massive damage to the Russian economy. For example, nearly 1,500 international companies have withdrawn from the country. Accordingly, the repercussions for investment and further trade with Russia are likely to be enormous, if only because almost five million jobs in Russia depend on foreign investment.




The Russian economy is also suffering enormously from the lack of imports from Europe. This is primarily due to the asymmetrical trade structure that Russia maintains with Europe. While Europe mainly imports raw materials from Russia and natural gas and oil alone accounted for almost 60% of German imports in 2021, Russia primarily obtains complex technological products from Europe, which play a decisive role in aviation and mechanical engineering, for example. Contrary to what is claimed, Russia cannot simply offset this dependence by increasing imports from other countries, for example China. On the one hand, many structures in Russia are geared to Western technology and cannot simply be substituted by Chinese products; on the other hand, China is also partially withdrawing from Russia. For fear of Western sanctions, Huawei, for example, has recently reduced its presence in the country. This is certainly also due to the fact that Western countries are far more important trading partners for China and should not be scared away. Many Chinese companies therefore do not risk being affected by Western sanctions if they continue to trade with Russia on a large scale. This will certainly have consequences not only for private individuals, who frequently rely on Western technology and software in their everyday lives. The military sector is also likely to face shortages, especially in the context of a lack of technology imports, because the Russian IT industry is far from being able to provide necessary alternatives in adequate quantity and quality.

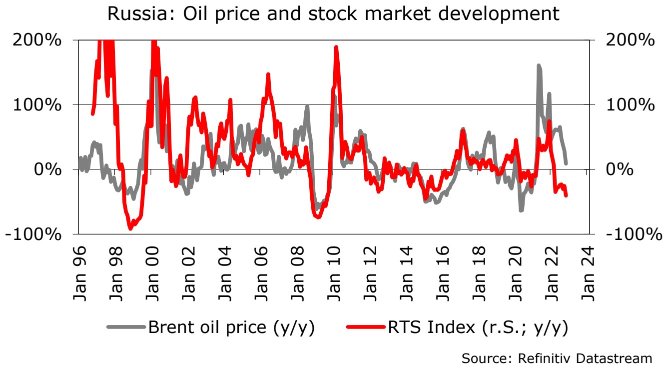
At the same time, Russia is also one of the most globalized economies among the developing countries - only Turkey and Mexico have an even higher foreign trade share of GDP in this group. As a result, sanctions against Russia are also having a negative impact on the Western economies themselves. Moreover, Russia has also taken economic countermeasures to respond to the pressure from the West.

The most obvious is the pressure Russia is exerting on Europe via the energy sector. Primarily because of its dependence on Russian gas, Germany is more affected than its European neighbors. On the one hand, gas demand itself is higher in Germany than in other European countries, because gas should play an important bridging role in the energy transition. On the other hand, the share of Russian natural gas in Germany was particularly high. This also applies to a number of Eastern European countries, but these either already have structures for LNG technology or are better able to draw on other energy sources than is the case in Germany. In contrast to the Crimea crisis in 2014, other sanctions imposed by Russia are likely to play a less significant role. At the time, some companies suffered particularly from the fact that they were affected by both the EU sanctions and the measures taken by the Russian side. The double burden at that time affected industries that had far-reaching consequences for the economy as a whole due to their value chain and led to a clouding of the situation in further industries. At the time, therefore, the impact on further industries was primarily due to a kind of leverage effect of the sanctions. At least in relation to the effects through energy prices and the great uncertainty caused by geopolitical tensions, the impact of these channels is likely to be smaller this time.

In the course of the development of energy prices, however, another paradox arises with regard to the effectiveness of the sanctions. While German exports to Russia have fallen by almost 35% in the current year, the value of imports from Russia has increased by more than half. This, of course, raises the question of how this will stop the financing of the Russian war. In fact, Russia is predicted to run a $285 billion trade surplus this year. This is almost equal to the amount of Russian assets frozen in Europe, Japan, America and elsewhere.

Nevertheless, it remains to be noted that the increased value of exports primarily reflects the price effect of energy goods. The money comes from a fortune that Russia has built up for "rainy days" and with which Russia has so far been able to finance many consequences of the war. Of course, even these assets will be used up at some point, but so far only about $75 billion of the nearly $300 billion still available has been spent. As is the case with many economic developments, it is likely that the West will have to be particularly persistent. However, given that almost 85% of Germany's imports from Russia are energy sources, the trade balance is likely to improve dramatically from now on as a result of the EU embargoes on oil and coal and the end of gas supplies.

Yet this will not be easy, that much is already certain. In one respect, Putin was probably right: There will not be what he called an "economic blitzkrieg".




*We would like to thank Ben Kerner for his active support for this article.*

## Market data

| Stock marktes | As of 30.09.2022 09:58 | Change versus 15.09.2022 -1 week | 19.08.2022 -1 month | 21.06.2022 -3 months | 21.09.2021 -1 year | 31.12.2021 YTD |
|---|---|---|---|---|---|---|
| Dow Jones | 29226 | -5,6% | -13,3% | -4,3% | -13,8% | -19,6% |
| S&P 500 | 3640 | -6,7% | -13,9% | -3,3% | -16,4% | -23,6% |
| Nasdaq | 10738 | -7,1% | -15,5% | -3,0% | -27,2% | -31,4% |
| DAX | 12113 | -6,5% | -10,6% | -8,9% | -21,1% | -23,7% |
| MDAX | 22098 | -9,6% | -18,1% | -19,7% | -36,8% | -37,1% |
| TecDAX | 2640 | -8,9% | -15,1% | -7,4% | -32,4% | -32,7% |
| EuroStoxx 50 | 3312 | -6,5% | -11,2% | -5,2% | -19,2% | -22,9% |
| Stoxx 50 | 3332 | -5,0% | -9,3% | -2,4% | -5,2% | -12,7% |
| SMI (Swiss Market Index) | 10193 | -5,1% | -8,6% | -2,7% | -13,5% | -20,8% |
| Nikkei 225 | 25937 | -7,0% | -10,3% | -1,2% | -13,1% | -9,9% |
| Brasilien BOVESPA | 107664 | -2,1% | -3,4% | 8,0% | -2,3% | 2,7% |
| Russland RTS | 1079 | -16,2% | -7,8% | -21,8% | -36,9% | -32,4% |
| Indien BSE 30 | 57334 | -4,3% | -3,9% | 9,1% | -2,8% | -1,6% |
| China CSI 300 | 3805 | -5,5% | -8,3% | -12,0% | -21,6% | -23,0% |
| MSCI Welt | 2401 | -7,4% | -13,9% | -5,6% | -21,3% | -25,7% |
| MSCI Emerging Markets | 873 | -8,9% | -12,8% | -14,1% | -30,8% | -29,1% |
| **Bond markets** | | | | | | |
| Bund-Future | 137,50 | -572 | -1467 | -583 | -3424 | -3387 |
| Bobl-Future | 119,77 | -176 | -534 | -135 | -1571 | -1347 |
| Schatz-Future | 107,20 | -34 | -210 | -89 | -507 | -483 |
| 3 Monats Euribor | 1,19 | 53 | 128 | 178 | 174 | 178 |
| 3M Euribor Future, Dec 2017 | 2,29 | 3 | 95 | 0 | 283 | 3 |
| 3 Monats $ Libor | 3,60 | 8 | 65 | 145 | 348 | 339 |
| Fed Funds Future, Dec 2017 | 4,00 | -5 | 55 | 0 | 392 | 3 |
| 10 year US Treasuries | 3,72 | 26 | 72 | 41 | 239 | 222 |
| 10 year Bunds | 2,13 | 38 | 95 | 37 | 246 | 231 |
| 10 year JGB | 0,25 | -1 | 5 | 1 | 21 | 18 |
| 10 year Swiss Government | 1,24 | 15 | 59 | -22 | 149 | 137 |
| US Treas 10Y Performance | 591,98 | -0,4% | -3,8% | -0,8% | -16,1% | -15,3% |
| Bund 10Y Performance | 554,00 | -1,3% | -5,7% | -0,1% | -17,6% | -16,4% |
| REX Performance Index | 436,15 | -2,4% | -5,0% | -2,5% | -11,7% | -11,1% |
| US mortgage rate | 0,00 | 0 | 0 | 0 | 0 | 0 |
| IBOXX AA, € | 3,15 | 22 | 86 | 19 | 291 | 267 |
| IBOXX BBB, € | 4,32 | 25 | 92 | 31 | 374 | 345 |
| ML US High Yield | 8,77 | 17 | 98 | 27 | 418 | 387 |
| Convertible Bonds, Exane 25 | 6427 | 0,0% | -6,3% | 2,0% | -22,2% | -21,5% |
| **Commodities** | | | | | | |
| MG Base Metal Index | 381,52 | -0,5% | -4,3% | -13,0% | -12,6% | -17,3% |
| Crude oil Brent | 89,13 | -2,1% | -8,0% | -22,3% | 19,3% | 13,7% |
| Gold | 1673,49 | 0,4% | -4,3% | -9,0% | -5,9% | -8,2% |
| Silver | 19,46 | 1,3% | 1,6% | -10,7% | -14,1% | -16,4% |
| Aluminium | 2177,50 | -5,3% | -9,0% | -13,6% | -22,9% | -22,4% |
| Copper | 7749,00 | -1,3% | -4,3% | -13,9% | -13,7% | -20,4% |
| Iron ore | 98,42 | -2,0% | -6,8% | -26,3% | -17,3% | -12,5% |
| Freight rates Baltic Dry Index | 1757 | 9,0% | 37,4% | -29,3% | -60,2% | -20,7% |
| **Currencies** | | | | | | |
| EUR/ USD | 0,9833 | -1,6% | -2,2% | -6,8% | -16,2% | -13,2% |
| EUR/ GBP | 0,8805 | 1,2% | 3,5% | 2,4% | 2,5% | 4,9% |
| EUR/ JPY | 141,90 | -1,1% | 3,1% | -1,3% | 10,6% | 8,8% |
| EUR/ CHF | 0,9602 | 0,3% | -0,1% | -6,0% | -11,5% | -7,1% |
| USD/ CNY | 7,0948 | 1,4% | 4,0% | 6,0% | 9,7% | 11,6% |
| USD/ JPY | 144,05 | 0,4% | 5,2% | 5,4% | 31,9% | 25,2% |
| USD/ GBP | 0,90 | 2,9% | 5,7% | 10,0% | 22,2% | 21,3% |

Source: Refinitiv Datastream

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