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Ukraine Crisis Nets Billions of Dollars for Kremlin

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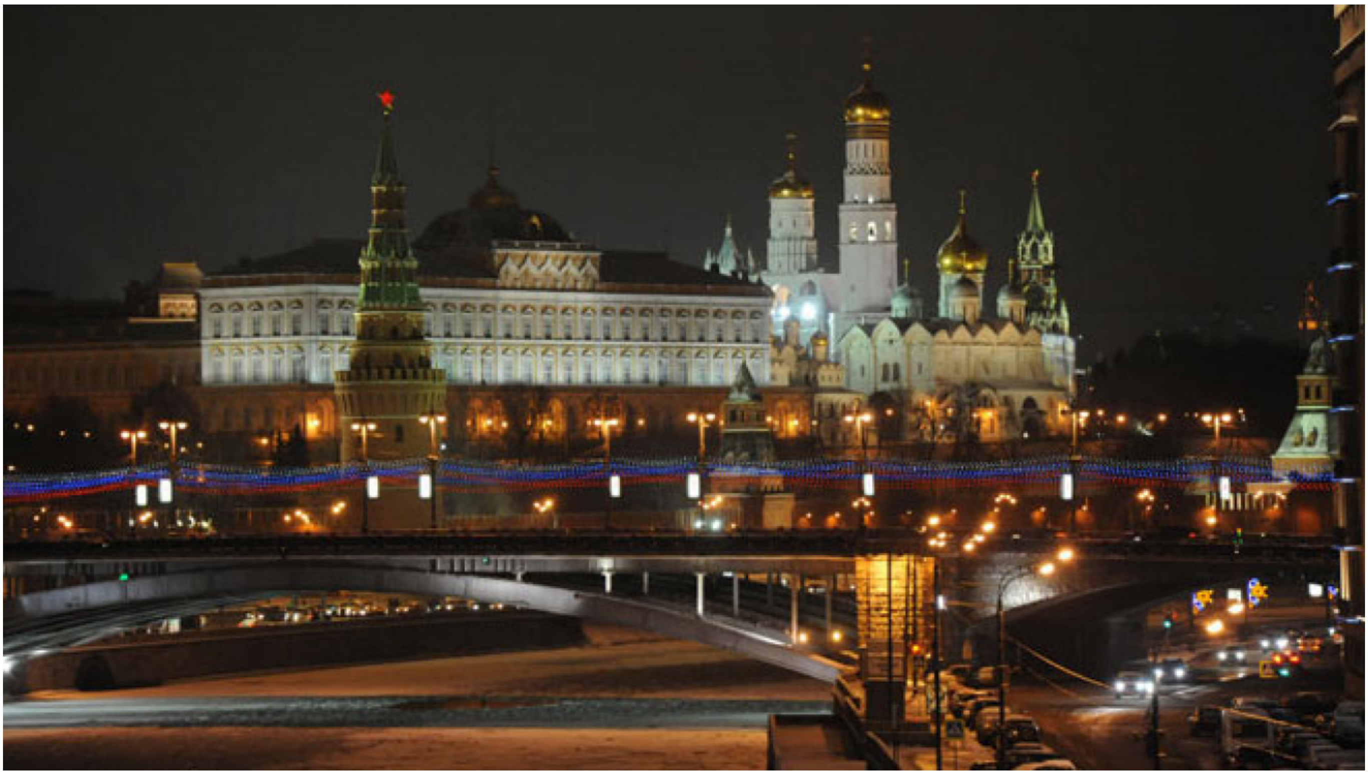

As the West is looking for ways to make Russia pay for the interference in Ukraine's domestic affairs, statements coming from diplomats mention threats to isolate Moscow economically.

A cheaper ruble and more expensive oil could actually go a long way in improving Russia's economy, possibly offsetting other potential aftershocks of the Ukraine crisis.

U.S. Secretary of State John Kerry in interviews on Sunday identified the ruble's slide as among Russia's economic challenges that could get worse if Western powers retaliated economically for a takeover of Ukraine's Crimea peninsula by armed men thought to be Russian troops. He was speaking after President Vladimir Putin won unanimous approval from the parliament to use armed forces in Ukraine.

The currency declined further in Monday trading, but a ruble that is losing value is a great prop for struggling local manufacturers, which now find themselves more competitive with Western imports. Besides, oil prices that edged up about $2 a barrel Monday are creating additional income for a federal budget that depends on these revenues heavily.

"Some of the consequences [of the Ukraine situation] can be for the better," said Oleg Kuzmin, an economist for Russia at investment bank Renaissance Capital. "First of all, it is the weaker ruble, which will ... slow down the growth in imports."

At the same time, Kuzmin warned that a devaluation that was too fast would come as a shock to businesses and the general public, casting doubt on economic stability. The Central Bank intervened in Monday currency trading with all its might and largely restrained the ruble downfall. Its official ruble exchange rate for Tuesday was only 19 kopeks more per dollar, an increase of about 0.5 percent.

In another effort to keep a lid on the exchange rate, the Central Bank temporarily raised its interest rates Monday, thus restricting access by banks to the money supply, which could end up being used to buy U.S. currency. If the measure lasts for more than a month, it could further chill the country's sluggish economic growth, Kuzmin said.

The effort comes despite the fact that a drop of 1 ruble in its exchange rate to the dollar gives state coffers an additional 180 billion rubles ($5 billion) of revenues, he said. The Central Bank set the exchange rate at 36.4 rubles per dollar for Tuesday, compared to the government's estimate of 34 rubles on average for this year.

But Russia will not be able to substitute all imports. The easiest replacements will be in the foodstuffs segment, while high-tech equipment has to come from the West if upgrades of the industry are to continue, Kuzmin said. Russia is also highly dependent on foreign medicines.

Combined with a cheaper ruble, the increase in oil prices raises the prospect of billions of dollars in additional funds streaming into state coffers. If the average oil price for the year goes up $1 per barrel, Russia stands to rake in 60 billion rubles more in export and other taxes, Kuzmin said. Gazprom, whose exports are another key source of revenue for Russia, links its prices for natural gas to oil.

As the West is looking for ways to make Russia pay for the interference in Ukraine's domestic affairs, statements coming from diplomats mention threats to isolate Moscow economically. British Foreign Secretary William Hague, on a visit to Kiev on Monday, said Russia was facing "significant costs" if it did not pull back its forces in Crimea. Kerry spoke about asset freezes and trade and investment penalties in Sunday interviews.

Former U.S. Ambassador to Moscow Michael McFaul tweeted on Saturday that "Russian companies and banks with business in the West will suffer as a result of reckless Putin decision. Will they speak up?"

But it is hard to imagine how the penalties might work when Russia is so integrated in the global economy and is home to assets belonging to numerous foreign partners, such as France's Renault, which owns a major stake in carmaker AvtoVAZ, or Germany's energy company E.On, which has teamed up with Gazprom for projects in Russia. In a situation like this, any freezes of Russian assets abroad might backfire, with Russia making reciprocal moves.

"I cannot see a total isolation they were able to impose on Iran," Charles Movit, senior manager for Europe and CIS economics at IHS Global Insight, said by phone from New York.

Other Options

Movit said the West could attempt banking sanctions to stop the flow of capital in and out of Russia. "They would be quite painful," he said. "But what if Russia says, 'Fine, but you do not get natural gas.'"

The West could also consider halting exports of high-tech machinery to Russia, something that the country needs to upgrade its industrial capability, he said. Movit and Ovanes Oganisyan, chief of domestic market advisory firm Midlincoln, said another isolation option would be for the European Union, whose annual trade turnover with Russia amounts to about 200 billion euros, to reduce its exports of consumer goods and foodstuffs to the country. That would mean losing a huge market, Oganisyan said.

He also suggested that like Iran, Russia could face restrictions for selling its oil and gas to some Western markets. It would be difficult to replace the volumes but they could try, especially as Iraq is set to ramp up oil production, and shipments of liquefied natural gas, or LNG, by tankers are becoming more popular, he said.

A news report said Monday that the White House could lift the ban on U.S. oil exports. The Reuters report quoted an analysis of past presidential decisions prepared for Senator Lisa Murkowski, the highest-ranking Republican on the Energy and Natural Resources Committee.

Russia's burgeoning export of nuclear power plants might also suffer. Czech Defense Minister Martin Stropnicky said Monday that it was hard to imagine that Russian firms could take part in the planned expansion of a Czech nuclear power plant after developments in Crimea, according to the news website idnes.cz, Reuters reported.

A consortium including Russia's Atomstroyexport is bidding for a contract worth more than $10 billion to expand the Temelin plant, alongside Toshiba's U.S. unit Westinghouse.

Weathering the Storm

Chris Weafer, chief of consulting firm Macro-Advisory, said he saw little risk for the Russian economy from any possible Western backlash. He said in a research note that major U.S. corporations, such as Boeing or ExxonMobile, who have been active in Russia for many years, have historically sidestepped political disputes.

Weafer played down the risk of a physical disruption by Ukraine to Russian gas supplies to the West, via a pipeline that traverses the beleaguered country.

"Gas disruption to the EU is not in Kiev's interest, as it needs the bailout and Western support," he wrote.

Mikhail Korchemkin, executive director of East European Gas Analysis, a Pennsylvania-based consulting firm, said he was of an opposite opinion.

"Transit of Russian gas through Ukraine can be interrupted any minute," he said. "It is early spring and ... Ukraine can survive without Russian gas until about mid-October."

The loss of six-month transit flow through Ukraine would mean a drop of export revenue of Gazprom of more than $10 billion, Korchemkin said. Shortage of cash may create financing problems for the Gazprom-led South Stream project to lay pipelines on the bottom of the Black Sea to circumvent Ukraine in exports to Europe, he said.

He also warned that the South Stream project is also very likely to slow down because of new political obstacles in Europe emerging due to Russia's approach to Ukraine.

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