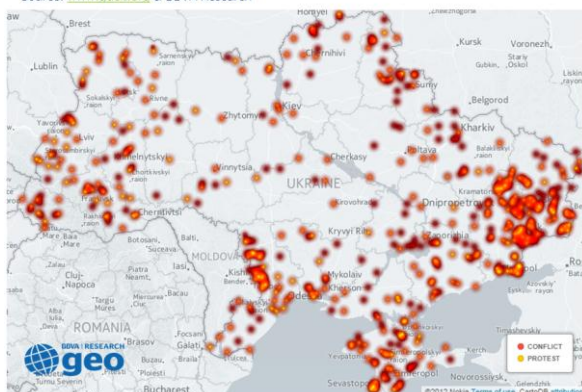


## Global Hot Topics

## The Russian-Ukrainian conflict: escalating tensions before negotiations

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Tensions are set to escalate as a strategy by countries to prepare for the presidential-level summit of Ukrainian, Russian, German and French leaders in Astana this month. The level of fighting is likely to be limited, but the risk of some “accident” or mismanagement is still present. The rapid deterioration of the economic situation in both Ukraine and Russia should favour the avoidance of more dangerous strategies. The risk for chaotic political scenarios and the potential spill-overs to the rest of EM Europe has opened the door to alternative solutions on the EU side. However, this is not expected in the short term.

**The situation in Ukraine: Conflict and Protest Index**  
(Protest/total events and conflict/ conflict events)Source: [www.odet.org](http://www.odet.org) & BBVA Research[Click here to see the interactive map](#)

**significant escalation in eastern Ukraine in the long run, although some low-level fighting could continue for some time. This strategy (“some limited pressure”) will be key for allowing Russia to fulfil two of its major goals: ensuring that EU sanctions are lifted and building the foundations for fulfilling the Kremlin’s long-term goal of making Ukraine a “neutral” state.** Despite the Russian measures to ensure that the separatist groups remain responsive to its guidelines, **the risks of some mismanagement by separatists or an accident is not negligible.**

**Tensions will escalate in the short term...**

**The fighting along the line of contact in Eastern Ukraine between separatists and ukrainian forces has returned to risky levels** (reversing the gains in December). **This pressure will stay alive as Ukraine, Russia and the separatists will continue to “prepare” for the presidential-level summit** in Astana (already postponed) at the end of this month. Beyond the increasing tensions in Donetsk (East), tensions are also increasing in the western part of the country (i.e. Transnistria and Odessa).

**The pressure will continue to increase as a lever in the ongoing negotiations.** Faced with growing financial and political constraints, **the Kremlin will not seek a**

**The critical situation and potential spill overs open the door for more constructive solutions**

**While the economic situation in Ukraine is already critical, Russia’s is starting to become serious.** In Ukraine, external financial assistance in the short term will be necessary to avoid chaotic scenarios from the economic, social and political points of view. The worsening of the 2015 outlook in Russia is also becoming a serious risk (the consensus of Russian GDP expectations for 2015 is now in the range of -3% to -6%). The combination of economic sanctions, the drop in oil prices and the rise of interest rates (from 10.5% to 17%) to control the rouble will provoke a sharp downturn in economic activity. With a remaining ample buffer of international reserves, **the Russian economy could withstand this scenario in the short term, but a prolongation of it could trigger important risks (social unrest) for Russia and spill-overs into Eastern Europe.**

**These risks have opened the door for discussions for a partial relief of sanctions.** On one hand, it looks as if **some of the EU countries (France and, to a lesser extent, Germany) would support a partial lifting of the sanctions and a more constructive strategy towards Russia.** In contrast, **some other countries (mainly in Central & Eastern Europe) point out that nothing has changed** on the ground and that Moscow has made no progress in implementing the Minsk agreement.

**Summing Up**

Limited **tensions are set to rise as a lever to the incoming negotiations,** while the risk of “accidents” by the separatists is still present. **The economic situation in Russia could open the door to a partial lifting of sanctions, but this is not likely at the moment.**

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