

## Global Hot Topics

## Ukraine-Russia: tensions will continue in 2016

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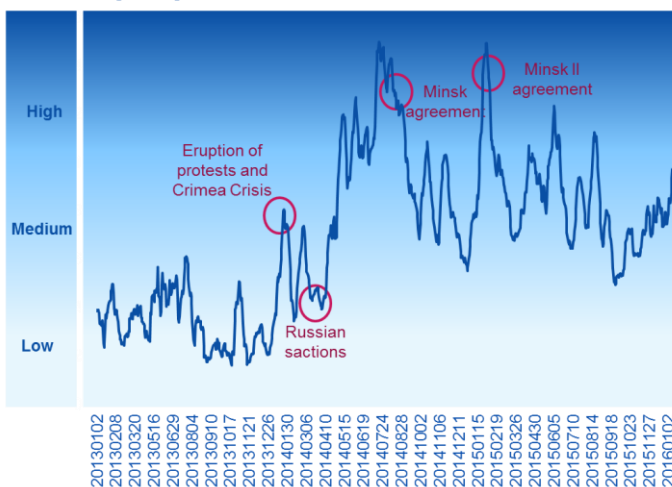
As 2015 was coming to a close, the relationship between Russia and Ukraine worsened after a convulse year with continuous ups and downs. The ongoing economic and geopolitical tensions between them have intensified during the last month owing to the suspension of Ukrainian electricity supplies to Crimea, the Ukraine-EU free trade agreement, the Russian restrictions on agricultural imports from Ukraine, the growing disputes over natural gas pricing as well as the possible Russian implication on the cyber-attack in Western Ukraine, which caused a blackout in the area. Since last month, there has also been a revival of the conflict in Eastern Ukraine with further risk of escalation, leading the Minsk II agreement to be extended into 2016.

## Conflict in Eastern Ukraine resumed in the last weeks with growing risks of escalating ...

## BBVA Research Ukraine-Russia Conflict Intensity Index 2013-16

(Number of events related to the conflict/ Total events in Ukraine on daily basis)

Source: www.gdelt.org and BBVA Research



The end of 2015 and the beginning of 2016 have been marked by the intensification of the conflict in Eastern Ukraine after two months of relative calm given the Russian shift strategy to the Middle East and a worsening in the geopolitical and economic relationships between Russia and Ukraine.

Fighting has recently escalated along the frontline in eastern Ukraine and it is likely to intensify. Russian-backed separatists strengthened attacks using heavy weapons on major flashpoints in Donetsk showing Moscow's intent to continue destabilizing Ukraine after a two months operational pause. The Ukrainian armed forces have also increased their offensive and the concentration of equipment and manpower in the area, signaling a potential escalation in the short term.

The recent events highlight once again the failure to advance the political requisites of the **Minsk II agreement** and the difficulty to move toward a lasting resolution of the conflict. Thus, the leaders of Ukraine, Russia, France, and Germany agreed to **prolong the unimplemented February 2015 Minsk II agreement into 2016**. Moscow's failure to implement the Minsk II peace process also led the EU at the end of December to **prolong economic sanctions against Russia until the end of July 2016**.

## ... together with increasing economic tensions between Russia and Ukraine...

The economic integration between Ukraine and Russia continues deteriorating with major risks to further weaken in the coming months. Some critical developments during the last weeks support it:

- The revival of tensions between both countries resumed at the end of November with the **disruption of electricity supplies from the Ukrainian mainland to Crimea** after Ukrainian radicals demolished the power lines serving the peninsula. With around 70% of the region's electricity coming from Ukraine, Moscow will be forced to speed up the construction of its energy bridge, which will bring electricity from Russia to Crimea.
- Ukraine blamed Russia of launching an **unprecedented cyber-attack on a power grid in Western Ukraine causing a severe blackout** in the area as retaliation for the disruption of power supplies to Crimea. If confirmed, it would mark a new era in the conflict which reinforces Russia's threats through unconventional modes of war.
- **Economic disputes escalated** between both countries **over natural gas pricing**. Ukraine has slashed its imports of Russian natural gas and announced an end to all imports of natural gas from Russia, arguing it could find cheaper supply from Europe.
- **Ukraine imposed moratorium on debt payments of \$3 bn Eurobond to Russia**. The default exacerbated tensions with Russia which took legal actions against Ukraine to recover the funds.
- The **EU and Ukraine** have started a **Free Trade Agreement**. The Ukraine's rapprochement to the West led **Russia to cancel free-trade zone with Ukraine and restrict all Ukrainian agricultural exports to Russia** as retaliation, seriously downgrading bilateral trade relations between both, which has fallen steeply since 2011 (from \$50.6 bn to \$12.5 bn in the first ten months of 2015).

## ... complicating the panorama for 2016

The ongoing economic and geopolitical tensions during the last month between both countries put into question the traditional high level of economic integration between them and signal a deadlock in their relationship with the potential to weaken over time. It introduces new challenges in both economies and makes even harder to find a solution to the conflict, which seems likely to drag on over 2016.

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