

## The effects of the invasion of Ukraine on the Spanish economy

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The invasion of Ukraine has been a crisis unfolding in slow motion, both in terms of its development and the reaction on the part of the EU. Following some initial surprise and restraint, awareness of the gravity of the situation and its geopolitical implications have led the EU to impose tough sanctions on Russia, affecting not only trade and individuals, but also the financial system, including denying various Russian banks access to the SWIFT messaging network and freezing the Russian Central Bank's foreign reserves. Limiting Russia's access to payment systems and its scope for intervening in the currency markets will have a major impact on its economy and its financial stability (indeed, the immediate reaction has been a steep rise in the Russian interest rate and capital controls).

As in the case of Iran 10 years ago, the sanctions and the exclusion from SWIFT are likely to translate into a sharp fall in Russian exports (including energy exports, despite these falling theoretically outside the embargo). Given the strong economic interdependence between Russia and the EU, the latter will also suffer. But this is inevitable: there cannot be effective sanctions on Russia without there being an impact on the European economy.

### How might this situation affect Spain?

Subject to the caution that must prevail when analysing such volatile circumstances, it is worth distinguishing between two types of effect: those in the first category, pertaining to the real economy, stem from the supply restrictions placed on energy products, raw materials and industrial products (both from Russia, owing to the sanctions, and from Ukraine, owing to the war); and the second category, of a financial nature, stem from the impact on prices and interest rates. In the case of Spain it is possible to predict that the latter will be significantly greater than the former.

To analyse the impact on trade and structural dependence the author proposes to use the BACI database compiled by the CEPII, a revised version of the UN's COMTRADE which includes more than 5,000 products bilaterally traded by more than 200 countries. The 2019 data will be used, because the most recently available, from 2020, are distorted by the impact of the pandemic.

With regard to the first category of effects, it is evident that Spain does not have a high degree of exposure to Russia in terms of energy dependency. In 2019 less than 11% of Spain's oil imports derived from Russia, considerably below Germany's 37% and Italy's 22%. With regard to gas, barely 6% of Spain's purchases come from Russia, significantly below the 40% average in the EU. This includes Italy's 37% dependence, Hungary's

58% and the Czech Republic's 84% (Germany does not distinguish between the sources of its gas imports, but it is estimated to be approximately between a third and 40%).

As far as agricultural goods are concerned, Spain's dependency has a microeconomic but not a macroeconomic importance: thus, Ukraine is the source of 38% of Spain's maize imports, a quarter of its barley and two thirds of its sunflower oil imports, as well as 10% of its wheat imports. With regard to other products, Spain imports much less fertiliser from Russia than other European countries and barely any gold (unlike the UK and Switzerland), copper (unlike the Netherlands and Germany), diamonds (unlike Belgium), palladium, platinum, titanium or iron.

Nor is Spain highly dependent on the Russian trade in services, excluding tourism. As far as the latter is concerned, 1.3 million Russian tourists visited Spain prior to the pandemic (highly important for regions such as Catalonia and other coastal and island regions), and a reduction in these numbers is likely as a consequence of the sanctions and the depreciation of the rouble. This will affect the revenues of such Spanish companies as Hoteles Melià, Amadeus and Iberia (the latter also as a consequence of airspace being closed). There is also the risk that sanctions will affect some Spanish engineering and consultancy companies.

There are no major Russian or Ukrainian investments in Spain, although it should be noted that the owner of the Dia supermarket company has been included on the list of those sanctioned by the EU owing to his reputed proximity to the Russian President. Nor are there major Spanish investments in Russia or Ukraine, in quantitative terms at least, although there are more than 130 Spanish companies operating in Russia and more than 30 in Ukraine, in industries such as textiles (Inditex), car parts (Gestamp and Grupo Antolín) and luxury articles (Tous and Lladró), not to mention those involved in tourism.

The most alarming effects for Spain at the macroeconomic level, however, will be those of the second category. The prices of oil and gas are already climbing and the normalisation forecast by the European Central Bank in the first half (enabling a rise in interest rates to be avoided) has now evaporated. Indeed, the gathering pace of fuel inflation could contribute to increasing expectations of inflation over the medium term, which may trigger spiralling prices and wages. In addition to fuel prices, a significant hike in food prices is likely, spurred on by a reduction in wheat (between them, Russia and Ukraine export more than 20% of the world total), barley (16% between the two) and fertiliser exports (Russia exports 14% of the world's fertilisers and most nitrogenous fertilisers). It should not be forgotten that some Mediterranean countries are highly dependent on Russian wheat (Egypt imports almost two thirds of its total from Russia) or that the Arab Spring of 2010 took place just after a marked increase in the price of wheat (in that case due to severe droughts in Russia and Ukraine).

The inevitable rise in interest rates will curb economic recovery in Europe, particularly those countries like Spain that were lagging slightly behind. As far as public debt is concerned, the strategy of the Spanish treasury of taking advantage of low interest rates to extend the average term of debt in circulation (in excess of eight years, compared with slightly over six years a decade ago) and the still low interest rates on new debt issues will enable the impact of such a rise on Spain's economic growth prospects to be

mitigated. It should however be borne in mind that in the context of uncertainty the difference compared to more secure assets will tend to grow, and that the difference between 10-year Spanish debt and German bonds has already leapt from 72 to 100 basis points between the beginning of January and the end of February.

Nor should we overlook the effects of this crisis on some of the emerging countries with which Spanish companies have a significant exposure, cases in point being some Latin American countries and Turkey. In the case of *Latin America* this is particularly due to the impact on borrowing costs (although levels of trade are minor, the direct investments in some countries are considerable), and in the case of Turkey (which was already suffering financial problems) due to both borrowing costs and trade, because after blocking the entry of Russian naval vessels to the Bosphorus and the Dardanelles, a degree of tension is to be expected with Russia, from which Turkey imports more than half its oil and two thirds of its wheat.

In conclusion, Spain's relatively low dependence on Russia may enable it to manage the effects of this crisis on the real economy (barring of course the serious effects on specific companies), but Spain's greater indebtedness and delay relative to the European cycle will place it in a poorer situation when the prices of fuel and food feed through into the rest of the European economy and interest rates and debt differentials start to reflect these increased risks.