Germany Inc. on Edge as EU Steps Up Response to Crimea

By Matthew Campbell and Alex Webb - Mar 23, 2014

As the European Union steps up its response to Russian president Vladimir Putin’s annexation of Crimea, German companies are urging caution lest sanctions harm their business ties -- and Europe’s shaky economic recovery.

The EU’s biggest economy has a lot riding on Russia. Volkswagen AG, Siemens AG, and HeidelbergCement AG are among the largest foreign investors there, the economic linchpin of a relationship nurtured by successive Berlin governments. Retailer Metro AG sells groceries to Russians, Adidas AG clothes the national soccer team, and Deutsche Lufthansa AG flies to more Russian cities than any other western European carrier.

U.S. President Barack Obama visits Europe this week, where he will confer with allies on further measures to deter Russia. Western officials have expressed concern about Russian troop movements near the Ukrainian border, which could worsen the crisis, U.K. Foreign Secretary William Hague wrote in The Sunday Telegraph yesterday. The EU on March 21 expanded the list of people subject to visa bans and asset freezes in response to Russia’s annexation of the Crimea to 51 individuals.

There will likely be opposition to tightening the screws too much. Gernot Erler, German Chancellor Angela Merkel’s coordinator for relations with Russia, told Bloomberg News last week that harsh sanctions would be counterproductive and unlikely to convince Putin to change course.

“We hope that politicians really think about the impact sanctions will have,” said Ulrich Ackermann, chief international economist at the VDMA, an association of 3,100 German machine makers, including Siemens and VW. “It’s important that they weigh what the effect will be not only on the country you want to hit, but also on the country that’s imposing the sanctions.”

Concrete Evidence

Among the large countries that use the euro, Germany sends the highest proportion of its exports to Russia, about 3.3 percent, Morgan Stanley analysts said in a March 20 research note. Bilateral trade between the two countries hit 77 billion euros ($106 billion) last year, and German investment in Russia totals 20 billion euros, according to the German Association of Chambers of Industry and Commerce.

Those close ties distinguish Germany from its European partners and, especially, the U.S., according to Bernd Scheifele, Chief Executive Officer of concrete producer HeidelbergCement AG.
“The greatest risk is if the Americans play power games -- since they have very limited trade with Russia they could very well do so,” Scheifele told reporters on March 19. “If the Russian state has no money, then all infrastructure and construction projects come to a standstill.”

**Cold-War Rerun**

Heidelberg, the world’s third-largest cement supplier, had about 500 million euros in revenue from Russia and Ukraine in 2013, with 21 facilities in the two countries. Scheifele warned that while the first two months of the year were in line with the company’s expectations in Russia, an economic crisis could quickly change that.

Deutsche Bank AG co-CEO Juergen Fitschen said in an interview last week with Die Zeit that a “rerun of the Cold War should be avoided at all costs.” The bank has advised on a greater volume of takeovers involving Russian companies than any other foreign firm in the last two years, working on $74 billion in transactions, according to data compiled by Bloomberg.

Economic links mean that “in western Europe, Germany is the most exposed to the trade risk” of a Russian crisis, Deutsche Bank economists wrote last week. Germany’s gross domestic product could fall by 0.5 percentage points if Russia’s economy were to contract by 8.6 percent, they said -- a contraction that’s “obviously quite extreme, but not unprecedented” in Russia’s volatile post-Soviet history.

**Brandt’s ‘Ostpolitik’**

In Germany’s auto sector, Bayerische Motoren Werke AG (BMW) increased Russia sales 12 percent last year to 44,871 vehicles, data from the Moscow-based Association of European Businesses show. Any escalation in the conflict would mean re-evaluating BMW’s plans for the post-Soviet region, CEO Norbert Reithofer said March 19. Rival Volkswagen sold about 287,000 cars in Russia last year, accounting for 3.2 percent of VW’s global sales.

“Germany will be harder hit than almost all other countries” by sanctions, especially if Putin retaliates by halting gas shipments, said Holger Schmieding, chief economist at Berenberg Bank in London. “A stop of Russian energy imports throughout next winter -- that would stall the European and the German economic recovery.”

Germany’s close economic and political ties to Russia date to the early 1970s, when Social Democratic chancellor Willy Brandt embarked on his “Ostpolitik,” a policy of engagement with the Soviet Union.

**High-Speed Trains**

OAO Gazprom (OGZD), which took over Russia’s post-Soviet gas exports, in the 1990s began a partnership with BASF SE, Germany’s single largest consumer of natural gas. Today, BASF, the world’s largest chemical producer, gets half of its gas from state-controlled Gazprom.

In the last two decades, other German companies expanded in Russia to take advantage of the
newly capitalist country’s infrastructure needs and expanding consumer market. Siemens has offices in more than 30 Russian cities, supplying power equipment, high-speed trains and medical devices. In November, Adidas used a gala outside Moscow to unveil new uniforms for the Russian soccer team ahead of the 2018 World Cup, which it’s sponsoring. Adidas and Siemens declined to comment.

Dresden KGB

Putin, a fluent German-speaker thanks to his time as a KGB agent in Dresden, cultivated a close relationship with Gerhard Schroeder, Germany’s chancellor from 1998 to 2005. After he left office, Schroeder took a job with Nord Stream AG, a Gazprom-backed pipeline project.

Meanwhile, Russian gas exports to Germany have been climbing since Merkel ordered a shutdown of the country’s nuclear power plants. About 35 percent of German gas imports come from Russia, according to Morgan Stanley.

Germany’s not the only European country whose business community is concerned about fallout from the Ukraine crisis. In the U.K., London’s investment banks, lawyers, and public relations firms depend partly on Russian business, which has accounted for about 13 percent of the $63 billion raised in initial public offerings there in the last five years. And French companies like Renault SA (RNO), Danone (BN) and Alstom SA (ALO) have built large Russian operations.

“If the situation deteriorates, it will have an impact for sure,” Philippe Goebel, the Chairman of Union des Industries Chimiques, the French chemical makers federation, said March 20 in Paris.

Germany, though, has the most to lose, said Stephanie Hare, who studies European politics at advisory firm Oxford Analytica. And given the size of Germany’s economy, its pain could quickly become Europe’s.

“The fact is that Germany is the motor of European growth,” she said. “Anything that hurts the German economy has the potential to knock on throughout the Eurozone.”

To contact the reporters on this story: Matthew Campbell in London at mcampbell39@bloomberg.net; Alex Webb in Munich at awebb25@bloomberg.net

To contact the editors responsible for this story: Simon Thiel at sthiel1@bloomberg.net David Rocks