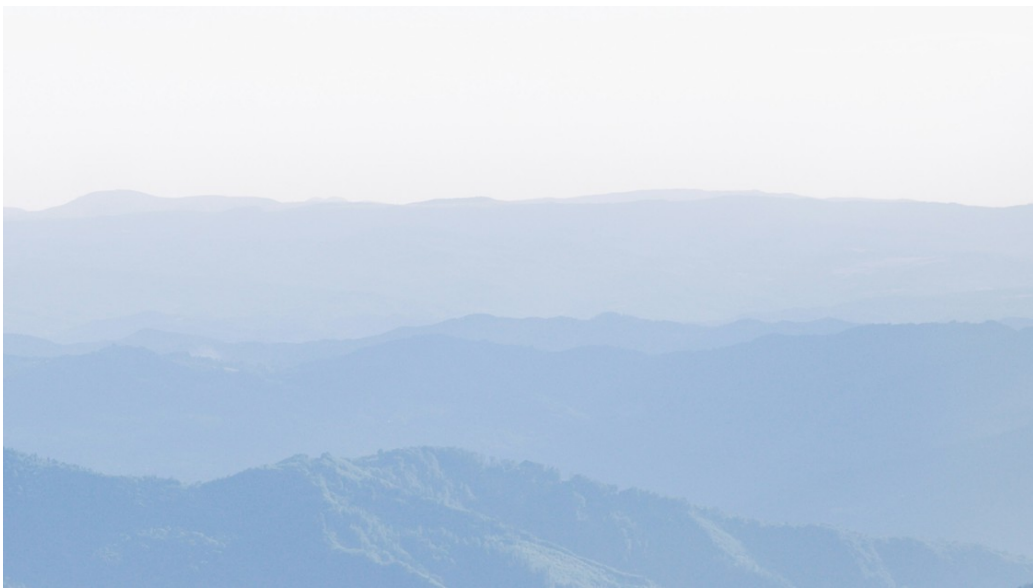


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Potential economic impacts of peace in Ukraine



As negotiations continue with a view to reaching a possible peace agreement in Ukraine, hopes are growing for an economic recovery in Europe. Markets are hopeful about the restoration of energy trade, as well as the reorientation of military spending. However, uncertainty over the outcome of the deal persists.

During his campaign, US president Donald Trump said that he would resolve the war in Ukraine in 24 hours. Although this promise was not fulfilled on his first day back in the White House, his administration has initiated discussions with presidents Zelenskyy and Putin about a potential peace deal, starting with a 30-day ceasefire. As these talks progress, capital has begun to return to European equity markets on the prospect of peace, and the hopes that it could kickstart a European recovery.

Potential economic impacts of a peace deal

The war in Ukraine has significantly affected European markets, leading investors to take a cautious stance on the region. This has started to reverse as markets hope that the end of the

war could lead to:

- **Restoration of energy trade:** Renewed energy imports from Russia could lower gas prices and inflation, which in turn could lift consumer sentiment and corporate margins.
- **Redirection of financial aid:** Reduced financial aid to Ukraine could free up funds for increased defence spending within Europe.
- **Easing of sanctions:** Lifting sanctions on Russia may enable more trade opportunities.
- **Boosted economic growth:** European companies are likely to play a vital role in the reconstruction of Ukraine, potentially stimulating growth across the continent.

Whether this will actually be the outcome of a peace deal between Ukraine and Russia remains to be seen, especially as the terms of a ceasefire, let alone a peace deal, have yet to be agreed.

Redirecting investments towards defence

Recent developments have served as a stark wake-up call to the fact that Europe must take greater responsibility for its own security. In turn, policymakers have taken accelerated steps to free up hundreds of billions of euros in military spending.

This increase in defence expenditure could provide a substantial boost to European industries, particularly in aerospace and defence, as demand in the sectors surge. The recent activity on European equity markets reflects these expectations. Cybersecurity could also gain prominence as Europe boosts its defence capabilities.

If a peace deal is reached, Europe may find an opportunity to redirect funds towards strengthening its own defence. According to Statista, EU institutions spent \$52.1bn on aid to Ukraine (including military, financial and humanitarian aid) between 24 January 2022 and 31 December 2024. Germany alone spent \$18bn. A ceasefire, followed by a peace deal, could allow budgets to be redirected towards strengthening Europe's defence, which is becoming an increasing priority.

But Europe would not stop spending money in Ukraine overnight. The UN estimates that it will cost \$524bn over the next decade to rebuild Ukraine, and European nations will need to contribute significantly to this effort. While this presents opportunities for economic growth through contracts for European firms, in particular within construction and civil engineering, it also poses challenges, as it may strain public finances.

The return of Russian gas?

Market optimism regarding a peace deal is also fueled by the potential resumption of Russian gas imports. Since the conflict began, European nations have drastically reduced their reliance on Russian gas, with the EU having set a non-binding goal to end Russian natural gas imports by 2027. However, the disruptions caused by the war and sanctions have led to an energy crisis, leaving European companies struggling with soaring energy costs compared to their US and

Chinese counterparts, which has hampered their competitiveness.

The prospect of re-establishing Russian gas flows is appealing for industries that have struggled under high energy costs, such as steel producers and certain chemical players. However, the willingness to resume dependence on Russian gas varies widely among European nations. Whilst a few EU countries could be willing to resume Russian gas imports, others may be hesitant to return to previous levels of dependence.

The end of Russian gas flows through Ukraine on New Year's Day marked a pivotal shift in the European gas supply landscape, signalling a decline in Russia's influence. Until that point, gas had continued to flow to some European nations via Ukrainian pipelines, but the latter's refusal to renew the transit agreement resulted in a complete halt. Consequently, even if European nations express interest in resuming imports, Ukraine may be reluctant to reopen its pipelines, regardless of any peace agreement.

Lifting sanctions?

The potential easing of sanctions could be used as a bargaining chip to achieve a peace deal or could be included as part of the terms of such an agreement. However, this is contingent upon numerous factors.

Currently, the US appears more open to this possibility than its European counterparts. The White House has asked the state and treasury departments to prepare a list of sanctions that could be considered for negotiation with Russian officials. If the US moves forward with easing sanctions, it is yet to be seen if Europe will follow suit.

Will peace in Ukraine be a turning point for Europe?

Whilst peace in Ukraine and the subsequent reconstruction could provide a substantial boost for Europe, optimism in markets may be premature regarding the potential economic outcomes and the expected timeline for economic impact. The region still faces significant challenges, including a lack of structural growth drivers. Defence spending packages will benefit European companies in the short term, but substantial investments in infrastructure, digitalisation and other critical areas remain necessary for sustainable long-term growth and a strong European recovery. In the near term, twist and turns in peace talks could continue to manifest as volatility on equity markets.

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