

War in Ukraine

Situational Awareness Briefing

12 July 2022



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Situational Awareness – Briefing as of 12 July 2022 (Summary)

Ukraine Crisis

The current geopolitical developments in Eastern Europe and the unprecedented attack on Ukraine are also an attack on our way of living and doing business together.

At the moment, no one can foresee all the consequences of this aggression. This is why urgent questions are now being asked in all areas of our social life. Also for companies this means far-reaching cuts and changes.

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The overview to the right represents a summary of points along the following five dimensions:

- Overall Geopolitical Assessment
- Industry Special
- Forecast
- People
- Operations
- Finance



Overall Geopolitical Assessment

After their occupation of Lysychansk, Russian forces have used this week for mop up operations in their rear as well as reorganization along the entire Donbas front. Ukrainian efforts against Kherson continued with minor gains. Russian forces seem to have stabilized the Kharkiv front as more static warfare has ensued along that front.



Forecast

China saw a high number of IPOs making it an attractive market for bankers in difficult times. Russian metal companies are canceling or postponing their investments in Russia and Türkiye, Iran and Russia are now discussing a potential cooperation to support their domestic automotive industries.



Operations (Focus: Cyber)

According to NATO Centre for Strategic Communication, Latvia has been experiencing possibly the most powerful cyber attacks in its history. Attacks on Latvia reportedly have intensified following an internal conflict with the Russian diaspora over the ban on celebrating Victory Day over Fascism on May 9 and 10. Russian hacker group RaHDIt has publicly released data on Ukrainian military intelligence officers. Reportedly, names of several thousand of intelligence officers and their relatives have been leaked online.



Industry Special: Construction

Construction companies in Europe are facing difficult times as their material costs experience extreme swings marking financing projects increasingly difficult. The UK has in comparison to its European peers also a labour shortage problem which can be traced back to Brexit. China on the other hand is increasing its infrastructure spending as a stimulus measure to counteract the damage done by the lockdowns.



People

Russian traders are moving their business from Switzerland to the United Arab Emirates due to European sanctions. It is reported that Russia holds at least 1500 Ukrainian civilians from occupied territories in prison in Kursk and Rostov. Mariupol city is still without water and electricity, mass burials in the city are increasing.



Finance (Focus: Sanctions)

The British government has announced to introduce new economic, trade and transport sanctions on Belarus for its support of the Russian invasion into Ukraine. After raising import tariffs on a wide range of goods and the sanctioning of individuals, the new package's import and export bans focus on oil refining and luxury goods as well as advanced technology components. After stopping vehicle export to Russia since March, German carmaker Volkswagen shut down one of its two production sites in Russia (Nizhny Novgorod assembly plant).

For questions, comments or details, please contact Joint Crisis Center team: de_ukraine-crisis@pwc.com



Key takeaways

- Russian forces prepare another large-scale operation along the Seversk-Bakhmut line in the direction of Sloviansk. In addition, troops are massed at Donetsk in anticipation of a breakout.

Current topics

Current situation in the Russo-Ukrainian War

The Kharkiv front has remained static as neither side attempted an offensive. Russian forces have stabilized their positions while Ukraine currently lacks the forces in the area to conduct an attack that can push the Russian forces to the border. Ukrainian attacks into the rear of the Iziurm salient have also stalled. Russia has about 22 BTGs concentrated at Iziurm that are preparing for an attack towards Sloviansk from the north. Since the occupation of Lysychansk, Russian forces have concentrated on mopping up remaining pockets of resistance. In addition, Russia has moved to reorganization, restructuring, and resupply of its forces and is preparing the next phase of operations in the Donbas. Flanking its efforts from Iziurm towards Sloviansk, Russian forces are advancing towards Seversk from the east. Further south they have intensified their attacks against Artemivsk/Bakhmut, aiming at cutting the highways from Seversk towards Bakhmut. Around Donetsk, a large concentration of Russian and separatist forces is gathering, and initial attacks indicate that a pincer maneuver to encircle the city of Andriivka will commence in the coming week.

The limited arrival of Western arms and their piecemeal transfer to the front-line troops had only minimal success to stem the Russian tide so far. While on the tactical level modern Western weapons have led to some success, their strategic impact has yet to materialize. The Ukrainian attack south of Vuhledar has stalled completely. While Ukrainian forces have conducted some very successful counter attacks throughout the conflict, so far they have been unable to conduct a strategic counter push. Ukraine lacks sufficient tanks, armored personnel carriers, artillery, and professional troops to initiate large-scale operations. Lack of ammunition, logistics infrastructure, and degraded morale as a result of months of fighting have shrunk the possibility of large-scale Ukrainian operations. Current Ukrainian operations, like those in the Zaporizhzhia and Kherson Oblasts, lack the scale, manpower, arms, and tenacity to effectively reverse Russian gains. Thus, it is likely that Ukraine will continue to rely on a flexible defense strategy, yielding ground where necessary to gain time for sanctions and arms transfers to make an impact.

Preparing the West and Western businesses for post-conflict hybrid attacks

Deterrence has been a cornerstone of Western security, both conventional or nuclear, since the onset of the nuclear age. It can work in two ways: by threatening retaliation, i.e., deterrence by punishment, or by denying success, i.e., deterrence by denial. The former involves state A aiming to convincingly signal state B that a certain action or attack will cause prompt retaliation by state A, including the destruction of essential assets in state B. The latter sees state A demonstrating resistance against state B without threatening retaliation, thus suggesting that state B will not be able to achieve its political and military objectives through an attack. The two forms may overlap. In light of unconventional or hybrid threats western states need to prepare for crises that go beyond classical deterrence. Modern societies and their business model with integrated, mutually dependent sectors and vital services are highly complex. This high level of connectivity can lead to severe disorder and disruption in the event of natural disasters, large-scale emergency situations or terrorist or hybrid attacks on critical infrastructure. Possible measures for companies and the governmental sector should include: strengthening information exchange between governmental and business sector to enhance the protection of critical infrastructure; establishing early recognition of crises to support decision-making processes in order to anticipate vulnerabilities; promoting a resilience-based security culture within companies that aims at a diversification of dependencies. As Russia and China have and will employ a variety of hybrid approaches against the West to flank their political, economic and military goals, governments, transnational companies and societies are in need to expand their resilience. Companies that provide central functions to modern societies as well as system-relevant services such as banking, logistics, energy production or basic goods will be exposed to the need of a permanent transformation process that is not only governed by economic necessities, but mainly driven by a need to reduce dependencies and vulnerabilities as well as overall sensitivity to external shocks. The primary objective of resilience is to ensure business continuity and adapt relevant services and products to market conditions even in a state of emergency, during a slow burning crisis, risk-stricken market conditions, or the constant threat of hybrid attacks.



Key takeaways

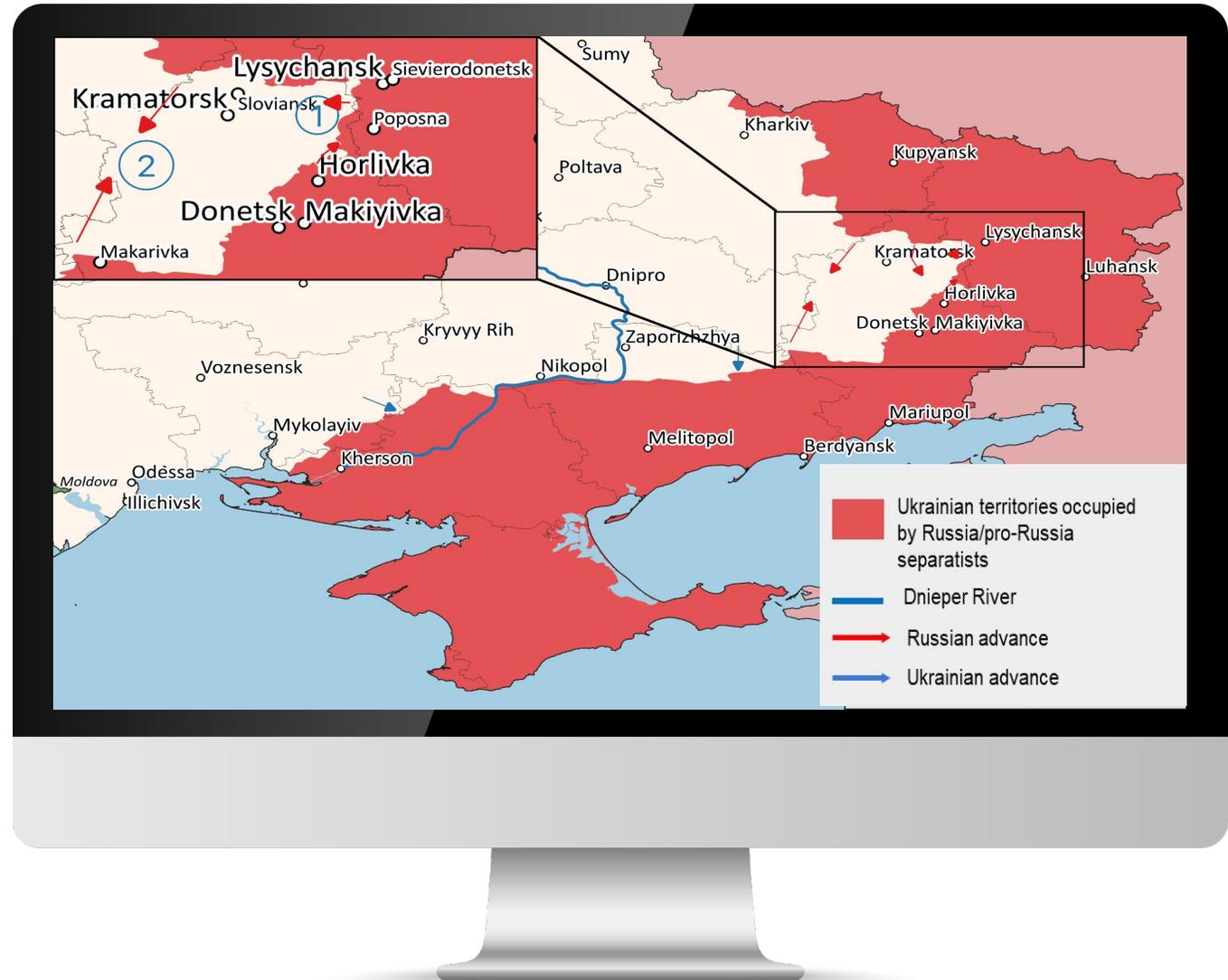
- The fall of Lysychansk and occupation of Luhansk Oblast pushed the front closer to Sloviansk, a cornerstone in Ukraine's defense in the East. Russian forces will concentrate their efforts to occupy the Donetsk Oblast to achieve one of their primary military goals.

Selected upcoming events

- 18 July: (EU) Agriculture and Fisheries Council** adopts legislation relating to the production of food
- 18 July: (EU) Foreign Affairs Council** (inter alia Exchange of views on Russian aggression against Ukraine
- 29-30 August: (EU) Informal meeting** of defence ministers

Current Military Situation in Ukraine

(arrows indicate potential future Russian operations in the coming weeks)





General context

The Russian invasion of Ukraine and the ensuing energy crisis hits in particular the construction sector. Important raw materials such as steel, plastics and ceramics are becoming increasingly expensive for building companies and heavily affect their ability to predict, plan and finance future projects. In China on the other hand investments in infrastructure are on the rise again as the CCP aims to get the country out of the economic drag created by the zero-covid strategy.

Current topics

Cost of construction at a 50 year high in Germany

Construction costs in Europe are on the rise. In Germany the cost of constructing a new building are at their highest since 50 years. The main driver behind this development are the higher Material costs, which are in the case of metals directly connected to the higher energy prices. Energy – which continues to be stoked by the ongoing invasion – is also major cost factor in the production of other building materials such as bricks, plastics and ceramics. Supply chain disruptions in Asia further add to these challenges. All of these factors put together resulted in 54.2% of German construction businesses stating they are currently experiencing bottlenecks and late deliveries with their raw materials. Many construction businesses in Germany now declare that projects are postponed indefinitely until the price changes are stable and the economic situation allows for contractual commitments again.

Record number of UK construction companies filing for bankruptcy

In the UK the situation has lead to 3,400 business going into administration in the year to April, which constitutes the highest number since the financial crisis. Bankruptcies in construction are now outstripping any other sector in the UK. These businesses usually employ fewer than 50 workers and are the ones who have the least buffer to handle the rising labor, shipping, energy and material costs. Construction materials usually account for 20%-25% of the cost of most building projects. Timber was up 30% in the year to April 2022, fabricated steel 45% and concrete reinforcing bars were 60% more expensive than a year ago. The UK has an additional challenge to handle, a significant labor shortage caused by Brexit and the pandemic. The UK has 244,000 fewer employees in construction compared to three years ago, mainly due to the loss of EU workers.

Large infrastructure projects are equally affected. The HS2 high-speed railway line between London and Birmingham was facing 30%-40% swings in costs of raw materials according to the chief executive Mark Thurston. Steel, for example, was costing GBP 800 a tonne compared to GBP 350 a few months ago.

Construction in China on the rise

China is again increasing infrastructure spending as a measure to support economic growth amid the continuing drag of Covid-19. Infrastructure spending rose almost 7% during the first five months of 2022 and total investment in newly started projects by 23%. Chinese state-owned enterprises revealed they planned to invest USD 1.5tn in non traditional infrastructure projects until 2025.

Preliminary Assessment

- Kaliningrad is also experiencing challenges with its construction sector. Due to the EU sanctions materials such as cement and steel become increasingly difficult to get.



General context

Considerations on implications for businesses along the PESTEL framework

P Political	Russia, Iran and Türkiye automotive corporation
E Economic	Chinese IPO boost and Russian companies cancel investments
S Social	Social related implications: e.g. refugee streams, labour market developments
T Technological	Technology related implication: e.g. cyber threats and disinformation, IT infrastructure disruptions
E Environmental	Environment related implication: e.g. Resource scarcity, energy embargo
L Legal	Legal implications: Compliance with changing regulations, contractual obligations, etc.

Current topics

IPO Market boost

China's IPO candidates have increased nearly to around 1,000, the biggest number in at least three years, thanks to a surge in listing requests from Chinese firms in June. As stock offers decline in other countries, this might make China a promising market for bankers. According to experts, the rush was partially caused by China's last month's loosening of Covid-19 regulations.

The solid pipeline in China indicates that the country's IPO market, which was the world's largest by fundraising in the first half this year, will continue to thrive in the second half. In terms of IPO volume, Shanghai's STAR Market led the world in the first half of this year.

A potential domestic economic rebound would "provide a favourable atmosphere for fund-raising," according to Louis Lau, Partner Capital Markets KPMG China. This climate may also benefit from an anticipated extension of IPO reform in China.

Russian metal companies cancel major investments

The financial impact from the western sanctions forces Russian corporations to cancel or reduce business development investments. Polymental, for example, has "indefinitely suspended" its plans to invest USD 730mn in a new gold plant in Sovetskaya Gavan, a city in Russia's far east. The investment will most likely go instead in part to Kazakhstan, which will deprive the economically depressed city of the much needed investment. Polymentatal also announced it would delay a USD 450mn investment in eastern Siberia by 12 to 18 months. As Russian metals, mining, and energy companies are heavily reliant on western technology to maintain their operations many Russian businesses must reassess their investment priorities admit the mounting sanctions.

Russia, Iran and Turkey consider automotive cooperation

According to Iranian Industry officials Russia, Turkey and Iran are considering a joint program to design and manufacture automobiles. This suggestion by Türkiye, aims at mitigating the effects of the current economic fallout and sanctions which particularly affect Russia and Iran. The cooperation between the three countries could particularly benefit the the supplier-manufacturer relationships between these countries as many important western technological parts need replacement in face of the sanctions. Further, the cooperation between the three nations would capture a large market for their products.

Preliminary Assessment

- In comparison to the same period last year, total listing applications increased by 31% at STAR Market, Shenzhen's ChiNext, and the Beijing Stock Exchange, China's three market places that have embraced the US-style IPO registration method.



Key Considerations

Response measures may include the following:

- Scenario planning sessions to explore how the escalating situation could impact the organization and identify the risks and mitigating actions.
- “Table-top exercising” can be used to validate response structures if they are not already in operation.
- Ensuring that playbooks are in place for extreme but plausible scenarios such as loss of IT for an extended period and disruption to critical suppliers.
- Ensuring the ability to locate all personnel based in, or travelling to, regions of conflict and ensure appropriate steps are taken for their protection.

Current topics

Russian raw materials companies move offices to Dubai

Russian traders are moving their business from Switzerland to the United Arab Emirates due to European sanctions - Rosneft, Gazprom, Lukoil and other largest companies of the Russian Federation are already interested in the "relocation", according to Bloomberg.

For example, managers of the Russian state-owned Rosneft reportedly arrived in Dubai last month to study the idea of a trading company. Meanwhile, as Bloomberg learned, Gazprom Neft also wants to expand its presence in the city. Litasco SA, the sales arm of Russian energy giant Lukoil, plans to move some of its Russian sales and operations staff to Dubai from Geneva in anticipation of it becoming the company's new headquarters.

There is also a wave of migration from the city of Zug, which has long been a center for the commodity trade due to its ultra-low taxes. For example, SUEK AG, the exclusive trader of coal from Russia's largest producer, plans to establish a trading business in Dubai.

EuroChem Group AG, one of the world's largest fertilizer producers with most of its assets in Russia, is also setting up a facility in Dubai. Both companies were previously owned by Russian oligarch Andriy Melnichenko.

Ukrainian civilians in Russian captivity

After the occupation of Kherson and Zaporizhia regions by Russian forces, it was reported by the Minister of Reintegration for Temporarily Occupied Territories of Ukraine, that Russia holds at least 1500 Ukrainian civilians in prison in Kursk and Rostov. Allegedly among captives are journalists, human right defenders, priests, activists and city councils. The difficulty is that civilians do not have protection under the law through which they could be transferred back to Ukraine.

Mariupol - update

The city of Mariupol, where 470,000 people lived at the beginning of the war, has been without electricity, water and heating for more than 4 months since March 2. Medical supplies are not imported into the city, and hospitals, according to the Ukrainian government, do not have the necessary medicines and equipment anymore to help those in need. Also, reportedly mass burials in Mariupol are rising in numbers. A Planet Labs satellite recorded the occupiers to continue to dig trenches in the cemetery. It is noted that since the occupation of the city, dead residents have been buried in such mass grave trenches. Compared to the May 8 satellite images, the area of mass burials in this cemetery has almost doubled. According to the Mariupol City Council, more than 15,000 citizens may be buried there.

Preliminary Assessment

- The UAE has developed its financial infrastructure for such relocation of commodity companies. In recent years, Emirati banks have become the backbone of commodity trade finance, multiple free trade zones have been established in Dubai, and its proximity to Middle Eastern energy producers and low taxation have also proved attractive.



NFT scammers see an opportunity in Ukraine donations

The Ukrainian government and celebrities have been promoting non-fungible tokens (NFTs) and cryptocurrencies to raise funds for the country's military during its ongoing war with Russia.

Although the tactic has proven to be effective - in the first five weeks of the war, Ukraine received more than USD 135mn in cryptocurrency donations - there's a downside. Like much of the cryptocurrency industry, donation campaigns for Ukraine are rife with fraud and scams, according to researchers.

On July 5th, Ukrainian open-source intelligence company Molfar published an investigation detailing how a firm called ZelenskiyNFT sold Ukrainian-themed NFTs allegedly to help the military and refugees, but instead seemed to have pocketed the money. Having identified multiple signs that point to a scam, Molfar reported ZelenskiyNFT as fraudulent content on NFT marketplace OpenSea and filed a complaint with the cyber police of the Czech Republic as well as Ukrainian law enforcement.

In February, OpenSea users lost USD 1.7mn in NFTs in a phishing attack; nearly USD 2.9mn was stolen when the Bored Ape Yacht Club's Instagram account was compromised.

"It's easy to fall victim to crypto scams in Ukraine these days," says Artem Starosiek, CEO at Molfar. "People are so eager to help their country that they rarely engage in critical thinking."

Current topics

Intense attacks by Russian hacker groups in Latvia

According to Janis Sarts, director of the NATO Centre for Strategic Communication (Stratcom), for more than a month Latvia has been experiencing possibly the most powerful cyberattacks in its history. Experts suspect Russian hackers behind the attacks. The deputy head of the Information Technology Security Incident Prevention Centre (CERT), Varis Teivans, said that Latvia's intention to demolish the Soviet Victory Park monument had attracted the attention of the Russian hacker group Killnet. Further, Parliamentary Secretary of the Ministry of Defence Baiba Bledniece claimed that the call for cyberattacks on Latvia was spreading on various Russian websites. According to her, there are about 100 targets on the hackers' blacklist, including even fitness clubs. However, local IT professionals manage to repel the attacks so far.

Average number of daily cyber attacks on Russia exceeds 200

The National Coordination Centre for Computer Incidents of Russia's Federal Security Service has been recording more than two hundred cyber attacks on Russian information resources on a daily basis since the start of the Ukraine war. This was recently reported by the centre's deputy director, Nikolay Murashov. The main goals of the attacks are disabling the IT infrastructure and gaining unauthorized access to the information systems of organizations in various industries.

Details of thousands of Ukrainian intelligence officers exposed

The Russian hacker group RaHDIt has publicly released data on Ukrainian military intelligence officers. Reportedly, several thousand of intelligence officers names have been leaked online. Among those compromised are representatives of embassy residences in Russia, India, Austria, Vietnam, South Africa, Italy, Turkey and Iran. Information on military intelligence handlers in Poland, Hungary, Bulgaria and Slovakia, sabotage instructors and representatives of special units for agent and force reconnaissance were also disclosed. The hackers explained that they had exploited a security breach in the networks of the Central Directorate of the Main Directorate of Intelligence on Rybalsky Island in Kiev. They were able to build the database by analyzing Big Data on user behaviour patterns and "digging into pension contributions".

In particular, the leaked documents concern criminal profiles of employees of the Main Directorate of Intelligence of the Ukrainian Defence Ministry. Among them were those convicted of serious crimes. Additionally, the hackers published data on the intelligence officers' relatives living together with them, as well as on individuals who received various payments from the accounts of the State Intelligence Directorate.

Preliminary Assessment

- Cyber attacks in Latvia have intensified since the start of Russia's war in Ukraine, but following an internal conflict with the Russian diaspora over the ban on celebrating Victory Day over Fascism on May 9 and 10, cyber attacks have become even more intense.
- According to some experts, apart from 200 strikes on important nationwide resources, there are as many as 300 per day in the regions.
- According to RaHDIt hackers, they passed the information about the people in contact with the Ukrainian intelligence service to law-enforcement agencies.



Key Considerations

Sanctions Screening Activities

- Screening solutions generate increasing number of alerts (especially banks must deal with the increased workload)
- Appropriateness and effectiveness of sanctions screening measures in identifying sanctioned parties and activities must be ensured. Complex ownership structures complicate the proper identification of involved parties (OFAC 50% rule)
- Trade transactions with Russia and Belarus must be reviewed

Sanctions Compliance Governance

- Sanctions Compliance Governance as a key requirement increasingly in the focus of regulatory authorities
- Robustness of Sanctions Compliance Management System and sanctions controls to counter the current and new sanctions regulations
- Adequateness of internal safeguards to prevent sanctions circumvention activities

Current topics

New sanctions by Great Britain on Russia and Belarus

The British government has announced to introduce new economic, trade and transport sanctions on Belarus for its support of the Russian invasion into Ukraine. After the raising of import tariffs on a wide range of goods and the sanctioning of individuals, the new package's import and export bans focus on oil refining and luxury goods as well as advanced technology components. Additionally, Britain bans more Belarussian companies from issuing their debt and securities in London.

Also six Russian individuals with close connection to the websites "SouthFront" and "NewsFront" were sanctioned for what London claims to be the spread of disinformation concerning the false narrative about what Russian President Vladimir Putin calls a "special military operation". The new measures allow for the immediate freezing of assets by British financial institutions.

Volkswagen to close production site in Russia

After stopping vehicle export to Russia since March, German carmaker Volkswagen announced to shut down one of its two production site in Russia. Due to the lack of critically important components from the EU, Ukraine and the disruption of value chains also within Russia, the plant in Nizhny Novgorod was closed on July 5. The Volkswagen Nizhny Novgorod assembly plant is operated by Russian GAZ Group and employs 200 workers. At Volkswagen's second directly owned plant in Kaluga work around 4,200 people.

Nord Stream 1 Pipeline started scheduled maintenance

Gas flow through the Nord Stream 1 pipeline from Russia to Germany went to zero this Monday due to a scheduled maintenance of the pipeline until July 21. However, markets are doubtful that the gas flow would be resumed after the maintenance. End of last week Canada stated that the turbine for the pipeline will be returned to Germany after repairs in order to ensure continued flows of energy until Europe can end its dependency on Russian gas.

Preliminary Assessment

- After the European Union's sanctions on Russian coal suppliers in April, Finland seized last week nearly a thousand freight cars belonging to Russia.
- German Minister of Economic Affairs and Climate Action Robert Habeck revealed his ministry's considerations of further sanctions against Russia.
- Following the extensive international sanctions packages, the British multinational bank HSBC is reportedly in extensive negotiations to sell its Russian lending business to the private Russian Expobank.
- French multinational energy company Total Energies announced its first major divestment in Russia in the wake of Western sanctions. After 20 years of shared production with Norway's Equinor, the company announced to transfer its remaining 20% interest in the Kharyaga oil field near the polar circle to country's state producer Zarubezhneft.

General remarks



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