The deepening sanctions battle over Ukraine is already tipping Russia into recession, rattling nearby economies and threatening to deal a blow to Europe’s wobbly recovery, which could damp global growth. Ian Talley reports. Photo: Getty.

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That fear of wider spillovers shows why the West is moving gingerly in cracking down on Russian President Vladimir Putin, say a host of economists and investors, despite mounting pressure from many U.S. lawmakers to quickly turn up the sanctions heat.

"It’s a bit like getting into a fight with your spouse," says Bryan Carter, a senior vice president at Acadian Asset Management, which manages more than $50 billion in assets for pension funds, governments and other clients. "You want to make your point without damaging anything."

From the outset, Europe’s fragile economy and concerns over a crimp in energy supplies have tempered the continent’s response to Russia’s aggression in Ukraine. Nations in the 28-member European Union are wary of a fight that would derail their emerging recovery.
U.S. President Barack Obama nodded to those worries Friday when he and German Chancellor Angela Merkel threatened sanctions that could target entire sectors of Russia's economy if Moscow disrupts Ukraine's coming presidential elections.

"There has to be extensive consultations" before moving forward with tougher sanctions, Mr. Obama said. "You've got 28 countries, and some are more vulnerable than others to potential Russia retaliation. And we have to take those into account."

Degrees of Exposure
The U.S. and Europe are weighing stiffer sanctions against Russia that could hit the financial sector and trade.

**BANK EXPOSURE TO RUSSIA (4Q 2013, IN BILLIONS)**

- Europe: $186.6
- France: $52.4
- Italy: $30.5
- Germany: $23.5
- U.K.: $17.8
- U.S.: $31.1

**EXPORTS TO RUSSIA (2013, IN BILLIONS)**

- European Union: $144.4
- China: $54.9
- Central/Eastern Europe: $30.8
- U.S.: $14.2

Sources: Bank for International Settlements (bank exposure); International Monetary Fund (exports)

Fears of a major ramp-up of sanctions came to the fore at a series of meetings between the world's top finance ministers and central bankers last month.

Roughly one-third of oil and natural-gas imports fueling Europe's economy are from Russia. Mr. Obama has said it is unrealistic to turn off the tap on Russian oil or natural-gas exports as the administration tries to calibrate how to pressure Mr. Putin without simultaneously harming Europe's economy.

The International Monetary Fund expects the euro-zone economy to expand by 1.2% this year after two years of contraction. Beyond the 18-nation currency bloc, the IMF was forced to cut the growth outlook in central and Eastern Europe economies that border Russia and Ukraine.
Sanctions targeting officials close to Mr. Putin and a few banks and energy firms have already rattled investor nerves in Russia and accelerated the country's downturn.

The ruble has tumbled to new lows as investors pulled an estimated $64 billion out of the country in the first quarter of the year, according to the Russian central bank.

The IMF last week said Russia already was in recession, citing the sanctions as it slashed Russia's growth estimate to 0.2% for the entire year from the earlier forecast of 1.3%. Standard & Poor's last week downgraded the country's debt to just one notch above junk.

Countries formerly in the Soviet Union—many of which are still caught in the Moscow orbit—are the most exposed to Russia's economic woes because of heavy energy and trade linkages. Belarus's exports to Russia last year, at $17 billion, accounted for one-quarter of the country's gross domestic product.

In contrast, Germany and China are the two biggest exporters to Russia, shipping nearly $100 billion in aggregate last year, but those products account for only about 1% of their economies.

Europe does have hefty bank claims in Russia, about $187 billion. If the West levied sector-wide sanctions on the financial industry, the loans and investments would likely be at risk. That could undermine efforts by Europe's financial industry to recover from the euro crisis.

Still, those bank claims only represent 1.4% of Europe's total foreign claims. For U.S. banks, it is an even smaller share: 0.5% of banking claims.

Targeting Russia's entire financial industry also could have a raft of unintended consequences in foreign-exchange and commodity markets, where Russian firms are a sizable player.

Those effects are difficult to quantify, but such sanctions could limit Russia's ability to sell its oil and natural gas in the global markets—threatening Europe's vital energy imports from Russia.

Instead of attacking the broader Russian financial sector, Mr. Obama pointed to trade finance, which would limit the broader economic fallout.

Both sides have a nuclear option in their sanctions arsenal: the disruption of energy shipments to Europe, a move that would send energy costs soaring in Europe and deplete Russia's primary source of government revenue.

As a result, Western officials so far have singled out Russian energy firms and banks that aren't deeply integrated with the European economy.

For example, the Obama administration targeted a company called Stroytranzgaz, an energy-service firm that primarily operates in Russia and is owned by a key ally of Mr. Putin's. Instead of hitting Russia's biggest oil company, OAO Rosneft, the administration sanctioned the firm's chief executive, Igor Sechin, another official in the president's inner circle.

Targeting sectors like defense and finance "is much more politically palatable," said Juan Zarate, a former U.S. deputy national security adviser in the George W. Bush administration, while aiming directly at the energy sector would have "deeper implications for the European and global economies."

Write to Ian Talley at ian.talley@wsj.com