

Sanctions against Russia: the government is becoming increasingly nervous

Iwona Wiśniewska

On 5 March, Singapore joined the Western technological and financial sanctions against Russia. Previously, several other Asian countries, including Japan and South Korea, took similar decisions. Taiwan has also joined the restrictions.

Further sanctions are also being imposed by international companies. The withdrawal of Visa and Mastercard from Russia will have serious consequences for customers in the banking sector. As of 10 March, cards issued by local banks will no longer be serviced outside the country.

For the first time, Vladimir Putin issued a comment on the Western restrictions: in his opinion "they look like a declaration of war on Russia". The president of the Russian Federation announced that his government would intensify its actions to counteract their negative consequences.

At the moment, these steps are still focused on stabilising the country's finances. On 5 March, Putin signed a decree that gives Russian borrowers the temporary right to use roubles to repay their foreign currency liabilities to creditors from the sanctioning states. In fact, this means a compulsory currency conversion at the central bank's rate; in addition, the money will be paid into accounts in Russian banks. Back on 2 February, the Central Bank of Russia (CBR) also temporarily withheld payments of liabilities to foreign clients, including the rouble bonds issued by the Russian finance ministry. As a result of these actions, on 6 March Moody's lowered Russia's credit rating to Ca, the second lowest rung on the ratings ladder. According to the agency, the central bank's tightened control of capital flows is likely to block the country's foreign debt payments significantly, and ultimately lead to its insolvency.

Moreover, the CBR issued an order limiting the value of foreign transfers made by individuals to US\$5000 per month. The government has also lowered VAT on the purchase of gold to 0%, in order to encourage its purchase, especially for convertible currencies. Due to these restrictions, the CBR has retained large amounts of gold, which it is finding difficult to exchange for the currency it needs. In an attempt to curb price rises on the food market, on 5 March the Russian government lifted existing restrictions on the import of vegetables from nine countries, including Turkey, Armenia, Azerbaijan, Belarus, Uzbekistan and Egypt. In addition, Belarusian enterprises will again be able to export meat, milk and animal feed to Russia. The government has also prepared a programme of special loans (with a maximum interest rate of 15%) for small- and medium-sized businesses, totalling 500 million roubles

(currently around US\$4.8 bn) in size.

On the news of Russia's probable insolvency in terms of credit obligations, the dollar rose against the rouble by more than 15%, and at the start of trading today it cost over 138 roubles. The Moscow Stock Exchange will remain closed on 7 and 8 March. Natural gas prices on the TTF exchange rose to over US\$2600 per thousand m³. Due to continued uncertainty about the future of the Russian oil sector, oil prices also rose significantly, and on 7 March a barrel of Brent crude oil cost around US\$130. Nevertheless, Russian Urals crude oil, the price of which is based on that of Brent crude, is currently trading at a large discount, averaging around US\$15–20 per barrel.

The effects of the sanctions are increasingly being felt in Russia. Restrictions on the aviation sector, together with fear of leased aircraft being confiscated at foreign airports, have led to Russian domestic carriers effectively suspending most of their foreign routes. The largest of them, such as Aeroflot and S7, have temporarily suspended all foreign flights (except for those to Belarus). In addition, external carriers are also halting flights to Russia (Azerbaijan's state airline is one example), as they are having trouble obtaining insurance for their aircraft to fly there.

At the same time, more and more grocery stores in Russia are introducing limits on the purchase of basic food products (sugar, flour, salt and oil).

Commentary

- President Putin's statement regarding the sanctions suggests that after almost 10 days of massive restrictions imposed by the West on the Kremlin, concern is growing over the crisis in many sectors of the Russian economy. However, it does not seem that this will stop Putin in his quest to take control of Ukraine and escalate the costs of the conflict, including for the West.
- Moscow's unilateral decision to convert Russia's foreign loan liabilities and pay them off in roubles constitutes a breach of the terms of the agreements concluded with the lenders. In effect, it will lead to the insolvency of the state. In March 2022, Russian companies, including Gazprom and Rosneft, should pay their creditors multi-billion dollar amounts of interest on the loans they have taken out. They probably have the currency they need, but government restrictions prevent them from transferring these funds abroad. On the other hand, the authorities can make payments in roubles in any amount, because the CBR can print however much money it might need to do so.
- The termination by Visa and Mastercard of their cooperation with Russian operators, which accounts for around 65% of global transactions, will mean that cards issued by Russian banks outside the Russian Federation will be suspended (cards issued by banks on US sanctions lists are already no longer supported by these payment systems). Within Russia, these cards will continue to be handled by the local National Payment Card System until their date of expiry. Russian MIR cards are currently accepted abroad only in Turkey, Vietnam, and some countries of the former USSR, including Belarus and Kyrgyzstan. This has led banks in Russia to look for ways to circumvent the restrictions, and above all, to extend the validity period of the cards they have already issued. They also plan to expand cooperation with other payment systems, including China's UnionPay

and Japan's JCB. Some of these banks (such as Gazprombank) have been issuing co-badged Mir/JCB and MIR/UnionPay cards, which allows them to be used abroad in countries where MIR, JCB or UnionPay cards are valid.

- Russia is unable to reap the full benefits of the rising oil prices. Although its oil and gas exports have not yet been subjected to sanctions, some companies (including from Finland and Sweden) have stopped purchasing Russian raw materials on the spot market. In addition, Russian Urals crude oil is significantly underpriced compared to the Brent brand (Shell has obtained a record discount, over US\$28). Moreover, freight prices have increased several times, as has insurance. Western countries cannot currently wean themselves off Russian oil completely (as it accounts for about 8% of global oil supplies, i.e. 5 million barrels a day), but they can significantly reduce their purchases of it. In 2021, oil and gas revenues accounted for around 35% of the Russian budget's income and around 55% of its export revenues.
- Russian air carriers, which have so far been hit the hardest by Western sanctions, are trying to devise a strategy to cut their losses. They are planning to use their leased planes for domestic Russian flights and assign the aircraft they own directly to foreign routes. However, this solution will not overcome another problem faced by the industry – their lack of access to spare parts and servicing (including periodic inspections). Their planes can be kept in working order for some time by removing parts from other aircraft, for example, but over time flying on foreign planes in Russia will no longer be safe.