April sanctions: implications for the Russian economy

On 6 April 2018 the United States imposed new round of sanctions against 15 Russian companies and 26 businessmen and public officials.¹ Such a wave of sanctions creates problems for the entire Russian economy let alone certain sectors.

Russian market response

Imposed sanctions banned American companies from working with Russian corporations and individuals on the new list.² American business must terminate until 5 June 2018 all transactions on contracts signed prior to 6 April with 12 Russian companies,³ and until 7 May—with Rusal, EN+ Group, and GAZ Group.⁴

Russian stock and currency exchanges were the first to respond to the new round of American sanctions. For example, four days after the announcement of restrictive measures the dollar exchange rate hit Rb 65 (for the first time since November 2017) and euro jumped to Rb 80.5 (for the first time since 4 August 2016). Moreover, MICEX and RTS indexes were down in trading by 9-11% on the back of Russian assets sale.⁵ Securities not only of Russian public companies in relation to which sanctions were imposed (RUSAL dropped 31.78%)⁶ but securities of other entities that were not slapped with US sanctions--Sberbank (-18.74%) and BTB (-8.84%)⁷ shed value. This is due to high share of state banks securities in the overall portfolio of investment funds as well as risks carried by Sberbank in relation to companies slapped with sanctions that Fitch estimates to reach $11bn.

In the context of stock exchange general instability, the Russian sovereign bonds depreciated (Russia-2030 down 0.8%, Russia-2047 down 2.81%, and Russia-2043

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¹ Full list of Russian citizens and Russian companies slapped with the US sanctions. URL: https://www.vedomosti.ru/business/articles/2018/04/06/756090-polni-spisok
down 3.75%). Now this can be assessed as a timeserving event. However, congressman Joaquin Castro introduced a bill on a new round of sanctions envisaging restrictions on transactions with Russia’s new Eurobonds that raises risks for the Russian sovereign debt.\(^8\)

Nevertheless, a slump seen on currency and stock exchanges did not last long—three days later the ruble bounced back half of what it had lost since 9 April,\(^9\) pointing firmer at Rb 61.19 per USD and Rb 76.16 per euro.\(^10\)

**Outcome for the Russian economy**

The long-term effect of imposed sanctions will lead to the foreign investment outflow, capital inflow from the Russian sanctioned companies as well as growth of their losses. The latter can negatively affect certain sectors of Russian economy.

For example, sanctioned Russian companies’ loss in capitalization further can create negative environment for the investors\(^11\) that can result in downgrading recently upgraded by S&P and Fitch agencies of Russian sovereign credit ratings. Thus, April sanctions represent threat not only for certain companies which status was hit on stock exchanges but a problem for the entire Russian economy.

The Russian aluminum industry can find itself in the most vulnerable position owing to the new round of sanctions. In particular, Rusal can come up short of 20% of its exports due to the loss of part of its external markets.\(^12\) For instance, the company can not ship its products to the U.S. and the London metal exchange stopped transactions with it. Business can lose part of their clients from other countries that may start to avoid transactions with a “toxic” company. Japanese companies Mitsubishi, Marubeni, Sumitomo and Mitsui&Co as well as Anglo-Australian Rio Tinto have done it already.

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9 On the effect of currency changes on trade (in particular, imports) see A. Knobel. Assessment of demand function on imports in Russia // Prikladnaya ekonometrika. 2011. No 4 (24), pp. 3–26
10 The ruble bounced back nearly half of its losses since the start of the week. Vedomosti, 12.04.2018. URL: https://www.vedomosti.ru/finance/articles/2018/04/12/766537-rubl-otigral-pochti-polovinu-padeniya
The global market of aluminum oxide has faced the negative effects of the sanctions where the Rusal’s share constituted around 7%. According to Financial Times, prices on shipments of aluminum oxide jumped 20% and of aluminum—5%.  
Sanctions will negatively affect the Russian banking sector whose losses can hit Rb 100bn due to capital revaluation and weak financial results affected by private sector’s slack demand for tight money. This will amount more than 6% of the banking sector income in 2018 projected by the Bank of Russia (Rb 1.5 trillion).  
Sovereign Eurobonds as well as new Russian offshore zones--new tools launched by the government can promote the return of Russian capital. The list of support mechanism can be expanded depending on the companies’ needs. For instance, they can be expanded by export credits, tax privileges, subsidized credits issued via development institutes, provide preferential access to state purchases and to investment contracts as well as establish a new institute to fight sanctions after-effects. However, these measures can notably decrease competitiveness of Russian companies in the long-term. Moreover, infusion of money into economy always bring risks of inflation. In case of strengthening of negative trends the Bank of Russia allows for raising the key rate.  
Capital outflow as a whole together with exacerbation of problems of certain companies can slow down GDP growth rates at 2018 year-end.  

Countersanctions are riskier than sanctions  
Submitted on 13 April 2018 by the State Duma a set of counter measures designed in response to the American sanctions proposes imposition of restrictions on metals, agricultural products, alcoholic beverages, tobacco, pharmaceuticals trade as well as

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13 Aluminium prices rally to highest level since 2011 // Financial Times, 16.04.2018.URL: https://www.ft.com/content/151f278e-419a-11e8-803a-295e97e6fd0b
14 German Gref has estimated losses of the Russian banks from market volatility in the amount of Rb 80—100bn. 17.04.18. URL: http://ru.reuters.com/article/idRUKBN1HO2FC-ORUBS?utm_source=34553&utm_medium=partner
19 The Bank of Russia lifted the taboo from raising the key rate // Vedomosti, 17.04.2018. URL: https://www.vedomosti.ru/economics/articles/2018/04/17/766877-tsb-klyuchevoi-stavki
cooperation in aircraft industry, rocketry, nuclear industry, consulting, auditing and law services.

On the one hand, this list of cooperation spheres spread to the most important spheres of Russian-American economic cooperation which is not close enough any way in relative terms. For example, the US share in Russian trade turnover in 2017 amounted to around 4%. On the other hand, The US economy is significantly larger and more diversified versus the Russian economy and can easily reorient to other markets and suppliers. Whereas Russia can fail to find alternatives. In view of this, there is a risk that countermeasures can be more biting for Russians than for Americans.

Russia does not produce analogues for certain drugs imported from the US. As of today, the US share in Russia’s imports of drugs amounts to 28%, whereas the total share of imported drugs on the Russian market in value terms exceeds 68.2% (as of February 2018). The Russian Health care Minister has confirmed Russia’s ill-preparedness to give up on import of original drugs.

Refusal from metals deliveries for the industrial production will not lead a crisis neither in the US nor in the EU countries. Missing link in the production chain (although it will cause growing costs in the short-term) can always be replaced with another and restore business process. Major manufacturers as American Boeing or European Airbus can obtain a competitive proposal for supplies of titanium of the global market. That is why the government does not see a refusal from cooperation with these companies as a countersanctions priority.

Undoubtedly, in the medium-term, we can expect the import substitution effect in a number of sectors (for example, agriculture, alcoholic beverages, tobacco products) but as in 2015 it will have its ceiling due to resource and production constraints on part of Russian producers. Ambiguity of proposed retaliatory measures forced the Russian government to put off their adoption.

Further measures designed to offset the impact from the new round of sanctions undoubtedly should focus on the solution of short-term issues. First of all, this is the case of raising funds for refinancing of Eurobonds by the Russian companies to the tune of $22.8bn until the end of 2019. In the long-term, the issue of raising funds for

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20 Foreign trade statistics. FCS of Russia. URL: http://www.customs.ru/index.php?option=com_newsfts&view=category&id=125&Itemid
23 Manturov excluded Russian ban on supplies of titanium for Boeing // RBC. 18.04.2018. URL: https://www.rbc.ru/rbcfreenews/5ad748429a79477cf203266c?utm_source=amp_full-link
the Russian economy will require revision of the fragile aspects of Russian foreign economic policy. China’s experience which weathered sanctions in the 1980s demonstrates that investor who left the country are bound to return.

Search for ways out of the current crisis is feasible via extended cooperation with international financial organizations—the World Bank and regional development banks. In particular, participation in banks’ projects in full parity with other developed countries (for instance, nanotechnologies development, other innovation projects) are of significant interest. Moreover, these institutes boast of high potential in raising investments in capital stock of private enterprises.