Sanctions produce chaos in Russian financial system

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1 March 2022

Russia's financial system has been thrown into turmoil following the imposition of sweeping sanctions by the US and the European Union with the explicit aim of trying to crash its economy despite warnings the effects could spread.

Seven major banks have now been excluded from the Swift international financial messaging system. In addition, the Russian central bank has been blocked from international operations to prevent it using the country's $630 billion of foreign exchange reserves to support the currency.

The rouble has fallen by around 20 percent from its already low levels and is now worth about one US cent in international markets. The Russian central bank earlier this week doubled its base interest rate to 20 percent to try and stabilize the currency.

Following the announcement of sanctions, the stock market closed. There was no trading in rouble-denominated bonds and the cost of derivatives to insure against a Russian default surged to 37 percent of the bond's face value.

In a statement earlier this week, Russian central bank governor Elvira Nabiullina said: "The conditions for the Russian economy have altered dramatically. The banking sector is now experiencing a structural liquidity deficit." In other words, there is a major problem in obtaining the money necessary to keep it functioning.

The major imperialist powers have made no secret of their aims. They are determined to smash the measures put in place by the government and financial authorities to try to insulate the Russian financial system following the imposition of sanctions in 2014 in response to the incorporation of Crimea back into Russia.

"Fortress Russia will be exposed as a myth," a senior Biden official said on Monday.

Yesterday, the French Finance Minister Bruno Le Maire was even more explicit. He said the West was using sanctions to wage "total economic and financial war against Russia, Putin and his government. We will provoke the collapse of the Russian economy."

This brought a sharp response from former Russian president Dmitry Medvedev, now deputy head of Russia' security council, highlighting the enormous dangers in the present situation.

"Today, some French minister has said that they declared an economic war on Russia," he tweeted. "Watch your tongue, gentlemen! And don't forget that in human history, economic wars quite often turned into real ones."

Le Maire said in response he should not have used the word "war." However, he did not pull back from the assertion that the aim of the sanctions was to bring about a collapse of the Russian economy.

The measures imposed so far may be escalated in the coming days and weeks. There has been considerable commentary in the financial press that they are insufficient because of the decision not to include a ban on the sales of Russian oil and gas on international markets.

An article in the *Wall Street Journal* said it was "hard to see a complete collapse of Russia's economy as long as it can keep selling its oil at almost $100 a barrel."

An editorial comment in the *Financial Times* described the exclusion of oil and gas payments from the sanctions as "regrettable" but said that, as long as Europe remained dependent on Russian energy supplies, sanctions on payments would be "pointless."

Even without the exclusion of Russian energy from the global market, the effect of the present measures is adding to the inflationary surge in the world economy. The price of crude rose to more than $100 a barrel—the highest level in eight years. In addition to oil, prices of wheat and other grains, together with key industrial metals, are also rising. The wheat price is now at its highest level since 2008.

Price hikes are heightening the problems for the US Fed and other central banks. They have been moving to increase interest rates in response to the rise in inflation over the past year to try and combat the push for higher wages by workers who have seen their living standards cut.

The conundrum for the Fed, which meets later this month to determine its monetary policy, is that increases in rates may be conducted in a stagflationary environment. Prices are rising, but growth is falling because of the supply shock which continues to be delivered by the ongoing pandemic and now the rise in oil prices.

There are also fears of major spillover effects from the sanctions on Russia on the international financial system as investors in the Russian market, which has been attractive because of the higher yields obtainable there, are hit.

"It's just so messy," one trader at a US brokerage firm told the FT. "If you trade something you can't settle it, you're left with the exposure." Global investors are reported to have at least $150 billion in Russian securities on their books.

There is also the prospect of a default by Russia on sovereign debt. According to Rick Rieder, chief investment officer for global fixed income at Blackrock, one of the biggest holders of Russian government debt: "There's not a lot of actual trading going on. Nobody wants to be on the other side."

Rieder said there was a possibility Russia could default on its bonds because of an inability to make payments to investors' accounts. "It's the difference between the ability to pay and desire to pay," he told the FT.

An editorial in the newspaper entitled "The shock and awe of sanctions on Russia"—a reference to the massive US military onslaught against Iraq in 2003—warned that urgent planning was needed to counter possible impact on the Western financial system.

"The negative consequences could be unpredictable, with some investors forced to sell their most liquid, safe assets—such as US Treasuries to compensate for Russian-linked assets being frozen," it said, adding that the effect could "ripple through supply chains in unforeseen ways."

The FT's Lex column warned that the world financial system was fragile, the pandemic is not over, governments are laden with debt and there was the scope for the Russian financial crisis to amplify other shocks.

"The subtlest of threats is of dislocations we cannot foresee: Lehman moments when panic spreads and markets seize up. Small or middling setbacks for businesses then become existential threats. The war means this threat is greater now than it has been since the early days of the pandemic."

On that occasion, in March 2020, Wall Street plunged, and the $22 trillion US Treasury market froze with a total collapse only prevented by a multi-trillion-dollar intervention by the Fed.

So far, American financial officials say, US markets are operating normally. But major swings on Wall Street are indications of nervousness in highly uncertain conditions.

Yesterday the S&P 500 fell 1.6 percent, the Dow lost 1.8 percent and the tech-heavy NASAQ dropped 1.6 percent. The S&P 500 and the NASDAQ have both recorded their worst two months to start the year since 2020.