Russia on the brink of debt default

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A Russian default on its international debt has come a big step closer with warnings from the IMF and the World Bank that it is very much on the cards because of the decision by the United States and the European Union to freeze the foreign currency assets of the Russian central bank they hold.

In an interview with the CBS program "Face the Nation" on Sunday, IMF managing director Kristalina Georgieva said that a Russian default was no longer "improbable."

The impact of the US-led sanctions was "quite severe for the Russian economy," Georgieva said, adding she expected a "deep recession" with the "abrupt contraction" already increasing the "heat" on the Russian population.

"In terms of debt service obligations, I can say no longer we think of Russian default as [an] improbable event. Russia has the money to service its debt but cannot access it. What I'm more concerned is that there are consequences that go far beyond Ukraine and Russia," she said.

Last week, World Bank chief economist Carmen Reinhart, said Russia and Belarus were "mightily close to default."

Asked if a Russian default could set off a global financial crisis, Georgieva said, "for now, no." The total exposure of banks to Russia was about $120 billion, an amount that while not negligible, was "definitely not systemically relevant."

That may be the case "for now," but financial events have a way of moving very rapidly. As recently as February 25, the three main international credit rating agencies had Russian debt at investment grade status. Now one of those agencies, Fitch, has said a default is "imminent."

The events of 1998 are being recalled when the $3 billion hedge fund Long-Term Capital Management went under following Russia's last default and had to be bailed out by the New York Fed lest its demise spark a broader financial crisis.

Warnings of a default have come from Russia itself. On Sunday, Finance Minister Anton Siluanov threatened to pay international bond holders in roubles rather than dollars when interest rate payments become due.

He said Russia needed to pay for critical imports such as food and medicines, but because of the limitations on foreign currency reserves "we will pay off our debt to those countries in the rouble equivalent."

It was "absolutely fair" that such action be taken until the sanctions, which have hit around $300 billion of Russia's total of foreign reserves of $630 billion, were lifted, he added.

An indication of whether Russia will default will come on Wednesday when it is due to make $117 million in interest payments on two dollar-denominated bonds, neither of which has an option for payment in roubles.

Russia is looking to China to try to work around the sanctions. However, China is under threat of sanctions itself if it takes such action.

The Biden administration's national security adviser Jake Sullivan said that China would face consequences if it tried to assist Moscow.

"We are communicating directly, privately to Beijing, that there will absolutely be consequences for large-scale sanctions evasion or support for Russia to backfill them," he told CNN.

"We will not allow that to go forward and allow there to be a lifeline to Russia from these economic sanctions from any country, anywhere in the world."

The impact of war and the imposition of sanctions is going far beyond the financial system. In her Sunday interview, Georgieva repeated earlier remarks that the crisis in the Ukraine could cause famine in Africa because of the escalation in food prices, particularly wheat, as Russia and Ukraine are major suppliers.

War in the Ukraine, she said, “means hunger in Africa.” However, it also had social implications for many, many countries because of the rise in commodity prices for energy, grains, fertilisers and metals, leading to higher inflation not only in emerging markets but also in major economies like the US.

In a clear warning of future recession trends, she said: “What do we do when we have to fight inflation? We tighten financial conditions.”

Speaking on the same program, financial analyst Mohamed El-Erian said the US Federal Reserve, which meets later this week to decide on its monetary policy, had “no good policy options anymore.” If it hit the brakes, it risked a recession or if it decided to just tap them “we have an inflation problem going into next year.”

El-Erian predicted that the US inflation rate, now at 7.9 percent, would probably get close to or even above 10 percent. At the end of the interview he articulated the fear in ruling financial circles—that under those conditions American workers will demand compensation for price hikes and if that happened “then we have that awful price-wage-price cycle.”

However, as workers are hit by savage cuts in their living standards and the people of Africa and in other poorer regions of the world face a hunger crisis, there are profits to be made, just as there have been during the pandemic with the rise of the COVID billionaires.

The *Wall Street Journal* (WSJ) reported at the weekend that hedge funds that had made “bullish bets on commodities are notching sizable returns from the biggest rally in decades following Russia’s invasion of Ukraine.”

Citing a “person familiar with the matter,” the WSJ said Soroban Capital Partners, a $10 billion hedge fund, was one of the biggest winners “making at least several hundred million dollars since February.”

Commodities-focused funds that made similar bets were posting “outsize returns—about 30 percent in the first two months of the year in some cases.”

Even before the Ukraine crisis erupted, as inflation was taking off around the world, it was clear there were big profits to be made from increased hardship and misery. In the annual letter to investors on January 20, Soroban founder Eric Mandlebatt wrote: “We are in the early innings of a generational opportunity.”