

The Impact of Financial Sanctions on Russian Economy

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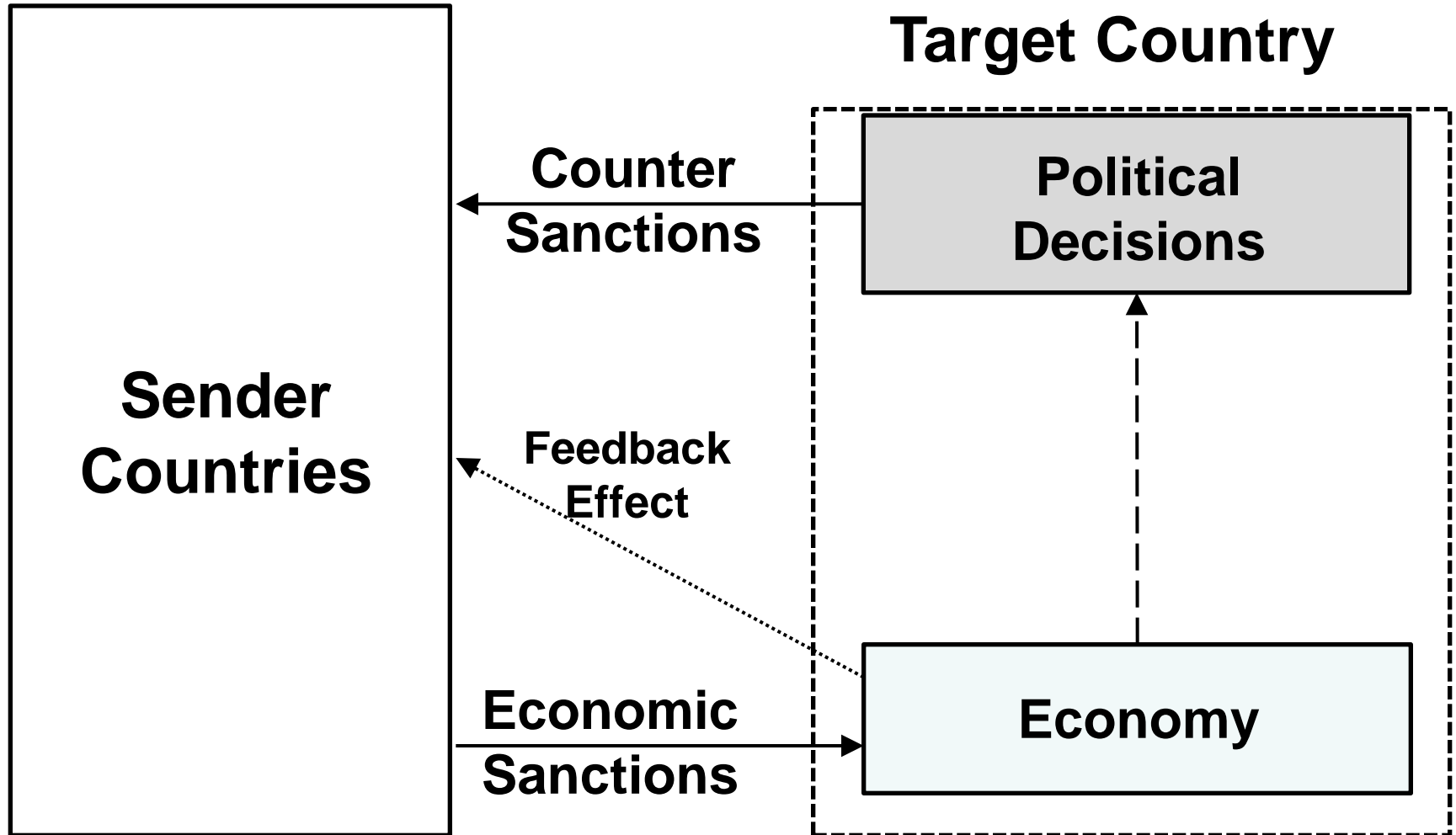
Economic Expert Group, Moscow

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Sanctions introduced against/by Russia in 2014-2017

| Category | Sender (s) | Primary Targets | Date |
|---------------------------------------|--------------------|---|------------|
| Financial | Advanced countries | State-owned banks and oil companies | July 2014 |
| Restrictions on technological exports | Advanced countries | Oil and military sectors | July 2014 |
| Personal ('smart') | Advanced countries | Top members of elites | March 2014 |
| Counter-Sanctions | Russia | EU agriculture and foods sectors | Aug. 2014 |
| Extended 'promissed' sanctions | USA | Public debt; Investors and suppliers of export pipelines; State-owned mining, metallurgy and railway companies; Top elites members. | Aug. 2017 |

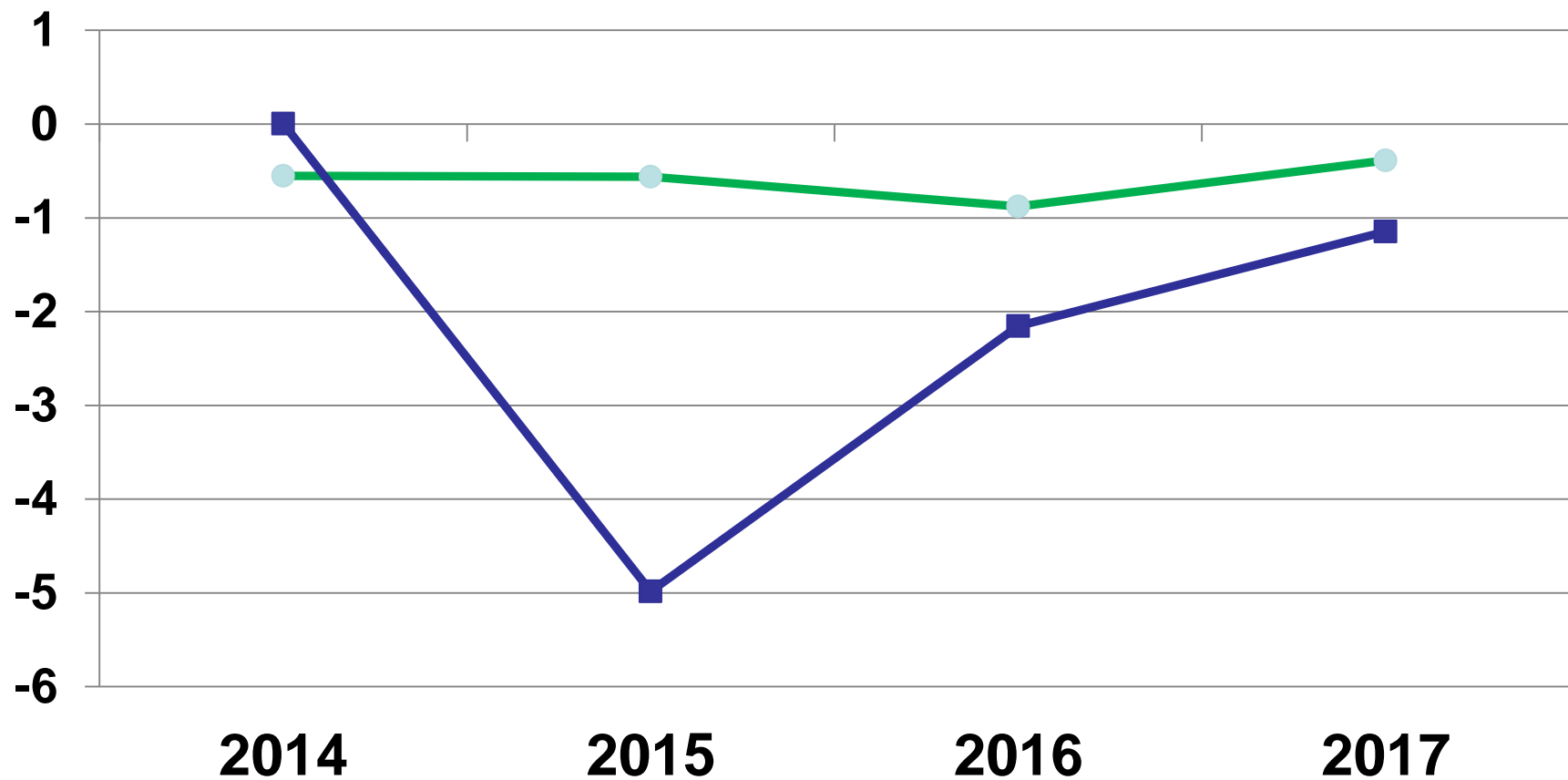
Sanctions Flow Chart



**Estimated impact of sanctions on the capital flows
based on 2014 Q3-2015 Q3 data, \$bn**
(Gurvich & Prilepskiy, Russian Journal of Economics, N.4, 2015)

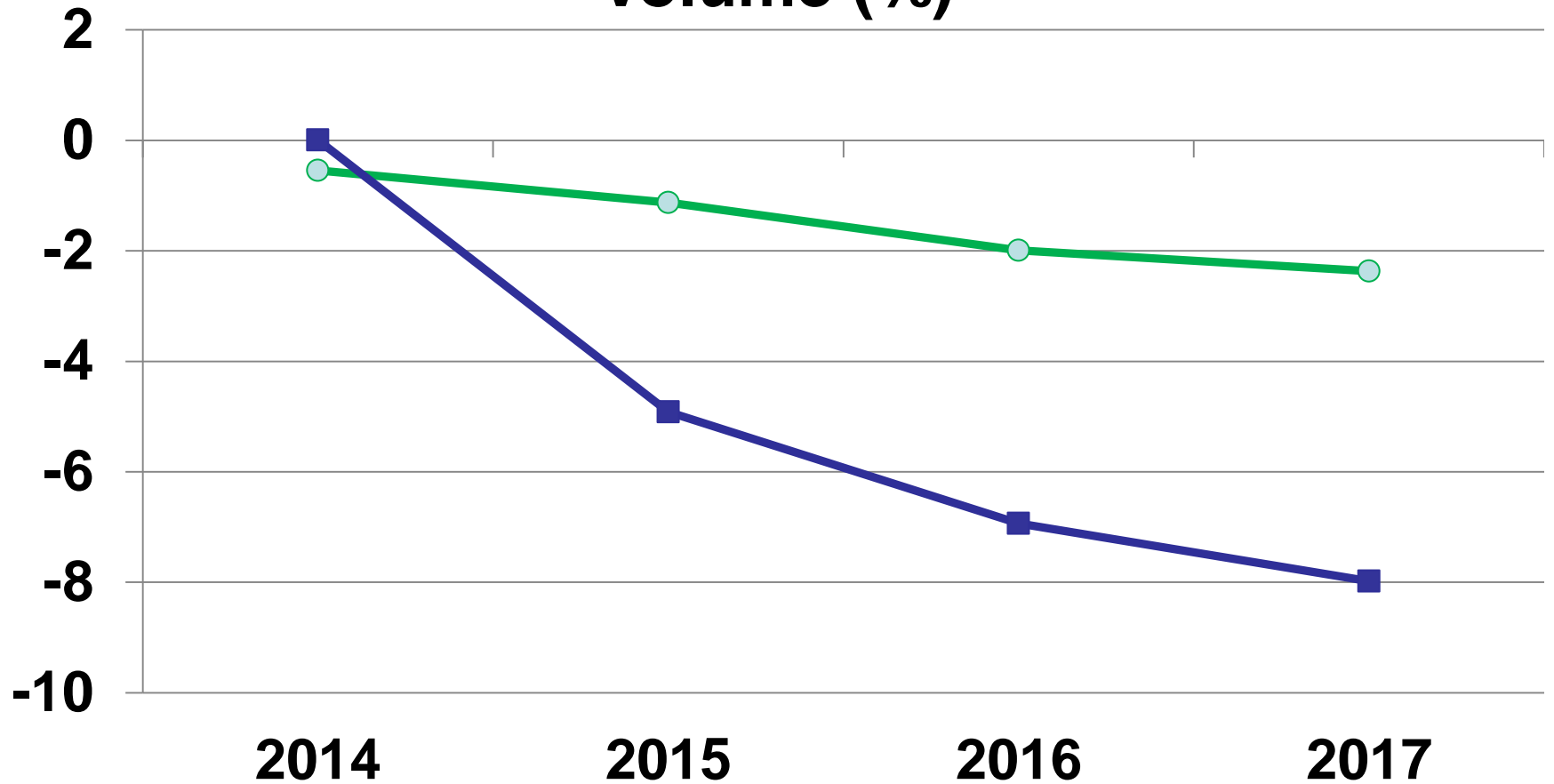
| | 2H2014 | 2015 | 2016 | 2017 | Total for 2014– 2017 |
|--|---------------|--------------|--------------|--------------|-------------------------------------|
| Gross capital inflow, total | -56.4 | -89.4 | -58.0 | -65.3 | -269.1 |
| Debt liabilities | -39.0 | -67.3 | -33.8 | -44.0 | -184.1 |
| Foreign direct investment | -17.4 | -22.1 | -24.2 | -21.3 | -85.0 |
| Gross capital outflow | -10.6 | -45.6 | -26.1 | -30.9 | -113.2 |
| Net effect from the sanctions | -45.8 | -43.8 | -31.7 | -34.4 | -155.7 |

Estimated Impact of Shocks on GDP Growth (p.p.)



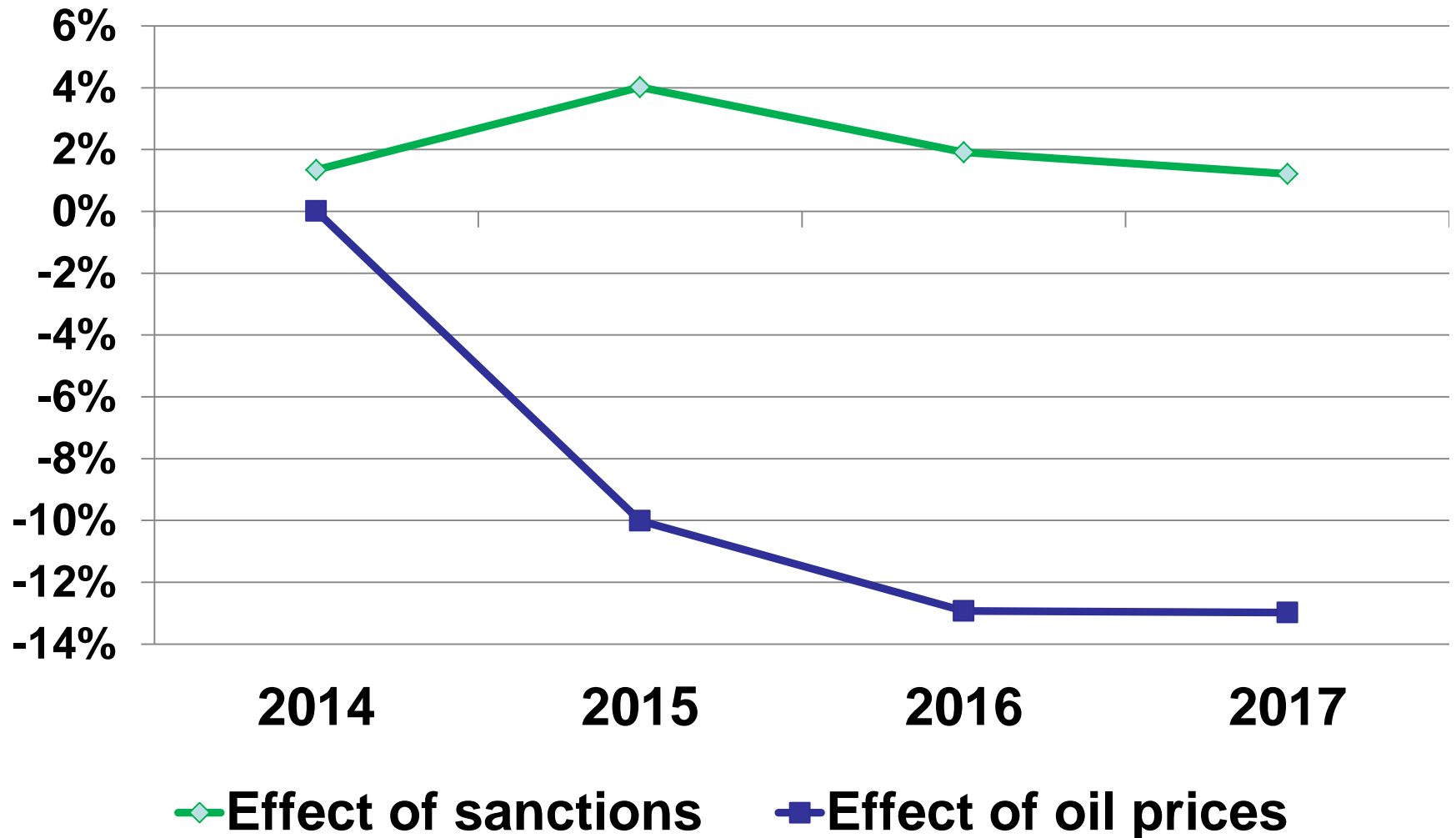
● Effect of sanctions ■ Effect of oil prices

Estimated Impact of Shocks on GDP Volume (%)

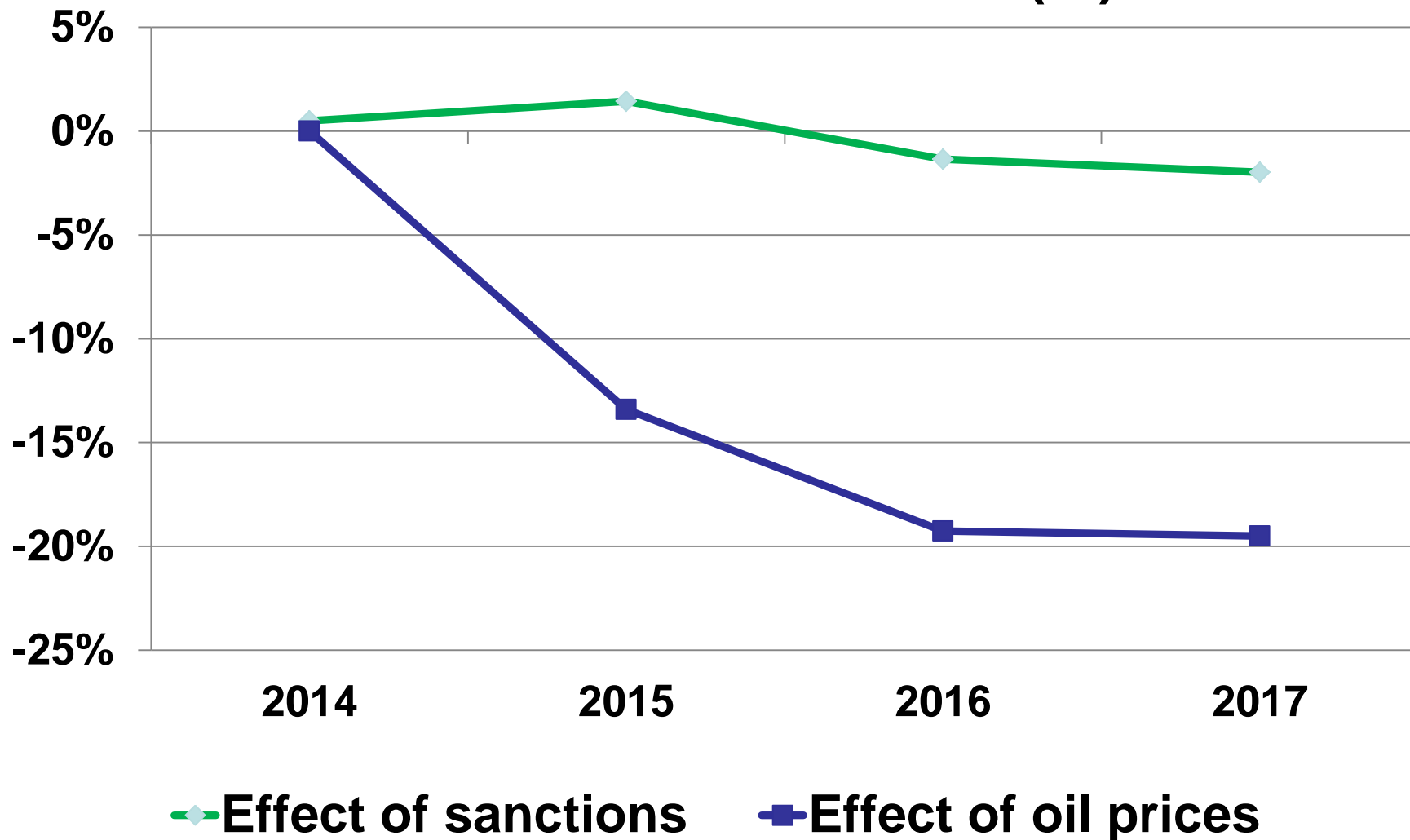


—○— Effect of sanctions —■— Effect of oil prices

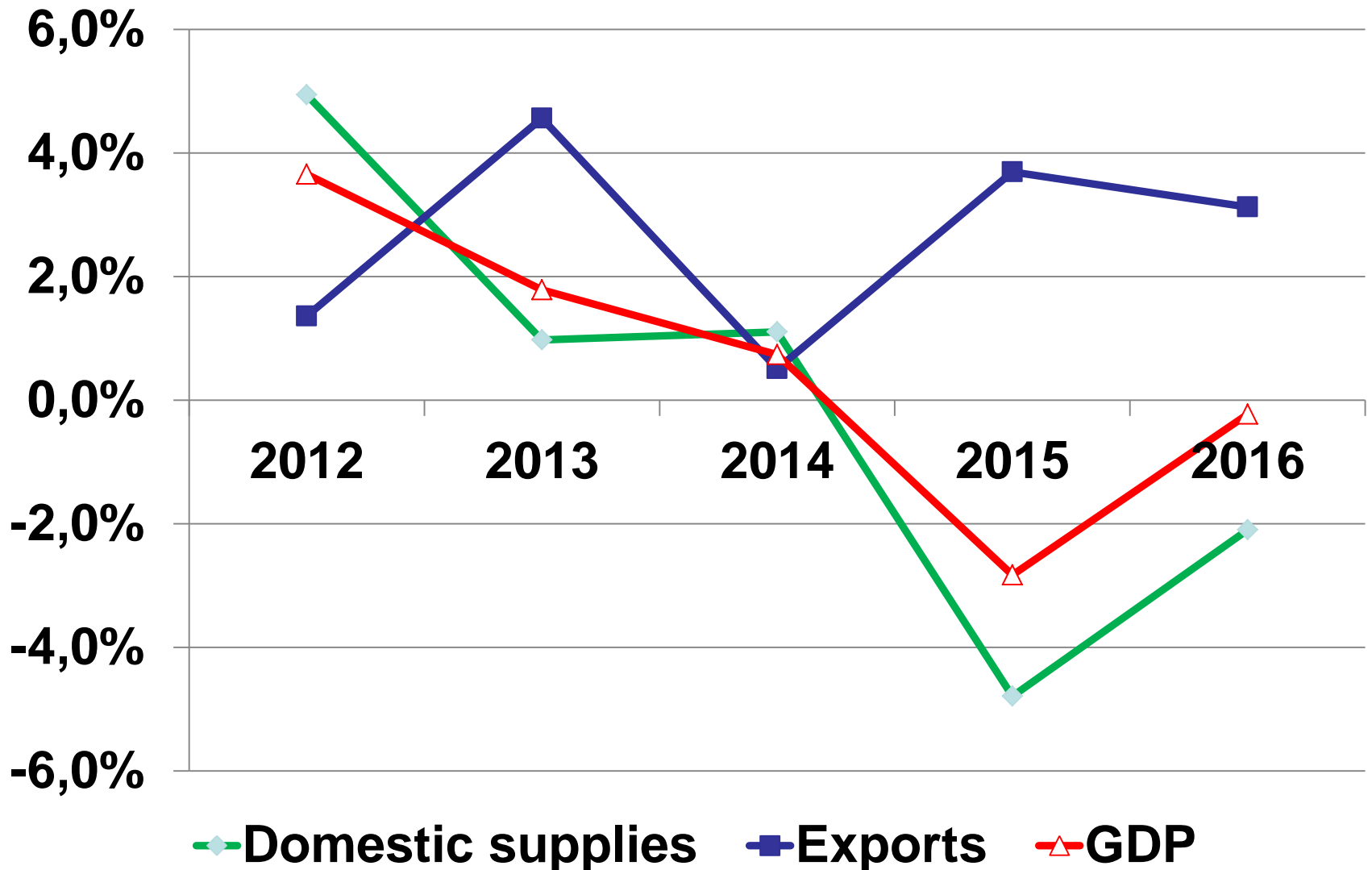
Estimated Impact of Shocks on Fiscal Revenues in Nominal Terms (%)



Estimated Impact of Shocks on Fiscal Revenues in Real Terms (%)



Growth Rates in Russia (%)



Russia's Government's measures and their effect

- “Turn to the East”: strategy dates back to APEC Summit in Russia in 2012, but has received increased attention since 2014.
- Hopes for tapping Asian financial markets have largely been dashed. Banks' liabilities to Asia-Pacific grew by just \$0.5 bn. in 2015-2016, and that too, only due to increased credit from China.
- APEC's share in Russia's trade has been growing continuously. In 2016, it displaced the EU as Russia's largest import partner. Still, in dollar terms, the trade turnover remains far lower than before 2014.

Scenario analysis for 2017

| | Old capital flow impact estimate | New capital flow impact estimate |
|------------------------------|---|---|
| Investment | -4.01 | -2.10 |
| Retail sales | -2.65 | -1.39 |
| GDP | -0.61 | -0.32 |
| CPI, end of period | +0.60 | +0.31 |
| Real exchange rate to dollar | -10.24 | -5.83 |
| Nominal budget revenues | +0.39 | +0.22 |
| Real budget revenues | +0.10 | +0.06 |

Scenario analysis for 2017

- Baseline compared to counterfactual of sanctions being lifted from the start of 2017, change in p.p.

| | Old capital flow impact estimate | New capital flow impact estimate |
|---------------------------------|---|---|
| Investment | -4.01 | -2.10 |
| Retail sales | -2.65 | -1.39 |
| GDP | -0.61 | -0.32 |
| CPI, end of period | +0.60 | +0.31 |
| Real exchange rate to dollar | -10.24 | -5.83 |
| Nominal budget revenues | +0.39 | +0.22 |
| Real budget revenues | +0.10 | +0.06 |

Updated estimates of sanctions' effect in 2017, % (Gurvich & Prilepskiy, forthcoming in 2018)

| | <i>Based on observations for 5 quarters</i> | <i>Based on observations for 10 quarters</i> |
|---------------------------------|---|--|
| Investment | -4.0 | -2.1 |
| Retail sales | -2.7 | -1.4 |
| GDP | -0.61 | -0.32 |
| CPI, end of period | +0.60 | +0.31 |
| Real exchange rate to dollar | -10.2 | -5.8 |
| Nominal budget revenues | +0.39 | +0.22 |
| Real budget revenues | +0.10 | +0.06 |

Estimated losses in the EU exports to Russia from sanctions (2016 vs. 2013)

| | |
|--|--------------------|
| Change in the EU exports to Russia (\$ bn.) | -64 |
| Overall change in Russia's imports (\$ bn.) | -150 |
| Estimated share of decrease of total Russia's imports attributable to financial sanctions | 6.5% |
| <u>Effect of financial sanctions on the EU exports to Russia (\$ bn.)</u> | <u>-4.2</u> |

Estimated losses in the EU foods exports to Russia from counter-sanctions (2016 vs. 2013)

| | |
|---|--|
| Decrease in the EU foods exports to Russia (\$ bn.) | -9.6 |
| Overall change in Russia's foods imports (\$ bn.) | -18.3 |
| Change of the EU share in Russia's imports of foods | -12.6 p.p. (35.2% to 22.6%) |
| <u>Effect of Russia's counter-sanctions on the EU foods exports to Russia (\$ bn.)</u> | <u>-3.1</u> |

Long-term effect of sanctions on the Russian economy

Potentially significant (negative): two major channels of advanced technologies transfer (the key vehicle of the catching-up development) are blocked:

- FDI dropped from \$69 bn. In 2013 to just \$7 bn. In 2015 (2016 is not representative due to Rosneft privatization).
- Supplies of some critical oil drilling, military and dual-use technologies have been forbidden.

FDI flows from the EU to BRIC countries

| | 2012 | 2013 | 2014 | 2015 |
|--------|------|------|------|------|
| Brazil | 25.0 | 45.0 | 32.8 | 28.9 |
| China | 16.3 | 20.9 | 8.8 | 6.0 |
| India | 5.3 | 4.7 | 4.8 | 6.2 |
| Russia | 19.1 | 6.4 | 1.6 | 2.1 |

Analysis Findings:

| | |
|---|--|
| Medium-term impact of financial sanctions on the Russian economy | Not critical, but material negative, fading |
| Long-term effect of sanctions on the Russian economy | Presumably strong negative |
| Feedback effect of sanctions on the European economy | Limited negative |
| Impact of the Russia's counter-sanctions on the European economy | Limited negative |
| EU lost profit from potential investment | Material negative |

Likely pre-conditions for obtaining desirable political objectives of sanctions

| Could favor political effect of sanctions | Actually observed |
|---|---|
| Economic considerations are prevailing over the geo-political ones | Geopolitical considerations are looking to be a priority |
| People are blaming the government for the damage to their standards of living from sanctions | It looks like most people believe that our economy has gained from sanctions and at the same time are blaming the sender countries for the damage to their standards of living from sanctions. |

Are popular views on the effect of sanctions true?

| | |
|---|------------------------|
| 'Russian economy lies in tatters' | No |
| Russian economy is immune to the sanctions | No |
| Sanctions are 'costless' for the sender countries | Not quite right |
| Sanctions have material desirable political effect | Questionable |