



– SPECIAL REPORT –

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RUSSIA IN SHOCK OVER NEW SANCTIONS



VLADIMIR PUTIN ON THE MEETING WITH RUSSIAN GOVERNMENT
SOURCE: KREMLIN.RU

- The sanctions imposed on April 6 by the United States on Russian citizens and entities proved to be a much stronger shock to the Russian economy than any other previous restrictions, starting from 2014. It shows the effectiveness of both Countering America's Adversaries Through Sanctions Act (CAATSA) as well as the so-called „Putin list”. Not only does it constitute a conscious blow aimed at the Russian economy but this is also an attempt to undermine the oligarchs' confidence in the regime.
- New package of restrictions against Russia was adopted by the Trump administration on 6 April and it immediately put an end to any Kremlin's hopes for good relationship with the United States. Only a few days later, both political and psychological weight of the sanctions was reinforced by the military operation of the Western coalition in Syria, preceded by Trump's tweet, in which he criticised Vladimir Putin and considered him to be co-responsible for the chemical attack in the Syrian city of Douma.
- The first results of the sanctions imposed on April seem to indicate that this may be the beginning of removing Russia from the global financial system, as previously in the case of Iran. There is no doubt that such a decision will negatively affect all of Russia's external business activity. In addition, Mr Putin will find it more difficult to compensate for the losses made by sanctioned entities, both companies and individuals. However, it will probably not change Russia's aggressive foreign policy. The American consistency in using such tools may force Russia to change its political course, especially if the Europeans followed their example.

On April 6, the Trump administration imposed new sanctions against Russian entities and individuals. The aforementioned restrictions include 24 people (17 officials, 7 oligarchs) and 12 companies, mostly related to sanctioned businessmen. As for their justifications, provided by U.S. Treasury Secretary Steven Mnuchin, the sanctions have not been imposed for any specific actions; instead, they aimed to punish Russia's overall policy with special attention to its malicious actions against Ukraine (Crimea and Donbass), Syria (by providing support to Bashar Al-Assad) and the West (mostly by undermining democracy and conducting cyber attacks). The foreseen restrictions mean actual elimination of an individual or a company from the U.S. market due to such moves as a ban on entry to the United States, freezing assets in U.S. financial institutions, a ban on American entities and citizens from concluding any transactions with sanctioned individuals and firms as well as ordering American citizens and entities to get rid of shares in sanctioned enterprises.

„BLACKLIST”

The restrictions imposed on 6 April constitute yet another step in the implementation of the so-called Countering America's Adversaries Through Sanctions Act (CAATSA) that obliges the White House to support the sanctions policy towards Russia. In the summer of 2017, the CAATSA was passed overwhelmingly by the U.S. Congress (House of Representatives 419-3, Senate 98-2), which meant that Donald Trump, who had not been eager to punish Moscow with any sanctions, reached a deadlock. He was forced to maintain a hard course against Russia; as a result, he signed the act at the beginning of August 2017. On January 29, 2018, the U.S. Treasury issued a list of Russian citizens who could possibly become subject to the above-

mentioned restrictions. The so-called „Putin list” contains 114 politicians and officials as well as 96 oligarchs; all of them are said to maintain close ties with the Kremlin. Such a warning gave some time to oligarchs from the „blacklist” to secure at least some of their assets; judging by the situation on the stock markets after April 6, they did not manage to take as much as possible during these three months. It seems that Moscow did not believe that the American would introduce any other sanctions in such a significant way.

For the first time, the „blacklist” of April 6 included representatives of business unrelated to the oil and gas sector, as well as their assets. Moreover, the restrictions targeted private sector operating globally, which has not

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happened before. Interestingly, the Trump administration hit Russian oligarchs who were not associated with the annexation of Crimea and the war in Donbass, do not belong to Putin's inner circle and who do not live mainly due to state orders. So far, the U.S. sanctions targeted politicians and officials, as well as those businessmen who maintained closed ties to the state apparatus. As for the economy, they concerned predominantly such sectors as banking as well as gas and oil. Individuals on the list can be divided into several groups. Surprisingly enough, among them there are a few oligarchs who are not associated with the Kremlin: Oleg Deripaska, Viktor Vekselberg and Suleiman Kerimov.



VLADIMIR PUTTING MEETING WITH RUSSIAN OLIGARCHS
SOURCE: KREMLIN.RU

Their presence on the list issued on April 6 appeared to be a serious shock for the Russian economy. In fact, most individuals targeted by the American restrictions belong to the very core of Putin's regime. First of all, they are mostly second-league businessmen and officials, however their position seems to be quite important, predominantly due to the fact that they handle Putin's money. Vladimir Bogdanov is the president of Russia's private oil producer Surgutneftegaz; the company, altogether with another private-owned oil-producing giant, has a strong position on the market that does not allow Rosneft to become an actual monopolist. But at the same time, it is the least transparent company, especially in terms of capital ownership. It has been said for years that even one-third of the shares of Surgutneftegaz is controlled by Mr Putin himself. The category of the so-called „Putin's treasurers” also includes young billionaires Kirill Shamalov and Igor Rotenberg. Their fathers, Nikolai Shamalov and Arkady Rotenberg respectively, belong to

Putin's inner circle since the beginning of his St Petersburg career and both take care of the president's fortune. The Trump administration has targeted top representatives of the Russian state apparatus, including Vladimir Kolokoltsev (minister of internal affairs), Viktor Zolotov (director of the Federal Service of National Guard Troops and Commander of the National Guard Troops and Putin's most trusted silovik) and Alexander Zharov (head of Roskomnadzor). Interestingly, sanctions were also imposed on the governor of the Tula region Alexei Dyumin. Putin's former aide-de-camp, who served both in the leadership of the Russian army as well as in GRU, is dangled as a potential future successor of the incumbent president. The list contains names of the heads of large state-owned entities, including Gazprom CEO Alexey Miller and VTB Bank chairman Andrey Kostin. There are also former KGB officers: Andrey Akimov (deputy chairman of the board of directors at Russian lender Gazprombank), Mikhail Fradkov (director of the Russian Institute

of Strategic Studies) and Evgeniy Shkolov (aide to Putin). As for Andrei Skoch, Russia's 17th wealthiest businessman and a business associate of Alisher Usmanov, was reportedly in charge of one of brigades of „Solntstevskie” gang. Criminal plot seems to be suitable in the case of Russian politicians Vladislav Reznik and Suleiman Kerimov accused of money laundering in such countries as Spain and France respectively. One can also notice another criterion, namely Russian interference in the U.S. presidential elections. Moreover, there remain such questions as Mr Deripaska's links to former Trump campaign boss Paul Manafort, Mr Vekselberg's financial support and alleged connections with cyber attacks (Konstantin Kosachev).

„BLACK MONDAY”

On April 9, the sanctions imposed by the United States on Russia caused panic on the stock exchange. The RTS Standard Index lost 11.44%. On Monday, all major Russian companies (not only the ones included in the American list) lost their capitalisation. Nobody knows what could have happened if the Russian government had not declared its eagerness to help the sanctioned entities in order to prevent the closure of factories and reduction of employment. It has somewhat calmed the Moscow stock exchanges; however, it was the worst session since December 2014 when stock exchanges collapsed due to the shock caused by downfall of global oil prices. According to the Russian daily RBK, fifty of the wealthiest Russian businessmen lost around 12 billion dollars in just one day.

The sale of Russian stocks was followed by the rouble's poor performance as it had begun to lose against major Western currencies. On April 9, Russia's rouble suffered its biggest daily fall in over three years. The next day, on April 10, the dollar exchange rate on the

Moscow Stock Exchange exceeded 63 roubles, which happened for the first time since

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December 2016. The sanctions shock had not yet passed, and a serious crisis has begun in Syria after Mr Assad's chemical attack in the city of Douma. Everyone started to talk about the possible threat of a direct military conflict between the USA and Russia. Due to the growing risk, investors have already started selling off rouble assets, including Russian governments bonds, with the aim of putting profit into dollar assets. According to the head of the Sberbank German Gref, such volatility of the financial markets could have affected the results of Russian banks in the amount of 80-100 billion roubles (1.3-1.6 billion dollars). Steadily rising interest rates in the United States along with falling rates in Russia have already reduced the profitability of Western short-term investments in Russian assets as they offered much more profits when the rouble-dollar exchange rate was more or less stable. But the last period of political and military destabilization hit the Russian currency. Even though, Russia's central bank did not intervene to help the rouble by selling some of its significant reserves in hard currency as it is too strong and thus contributes to the budget deficit. Since budget revenues depend heavily on selling oil and other raw materials to foreign customers (who pay in dollars), a weakening rouble means an increase in revenues denominated in the

national currency, while expenses remain the same, which seems to close the budget in an efficient way. It seems that the rouble may be threatened by some external factors related to the monetary policy of the US Federal Reserve. If the Fed keeps raising rates, the differences between the debt in the rouble and the dollar one will be so small that it will not compensate players for any risk and investors will see no point in investing in the Russian currency.

OLIGARCHS LOSE THEIR MONEY

Analysts of Forbes magazine have found out that Oleg Deripaska had lost nearly a billion dollars in just one day after the U.S. administration introduced new sanctions. Suleiman Kerimov lost 244 million dollars whereas Viktor Vekselberg, who disposes of a slightly smaller fortune, lost 41 million dollars. In the morning of April 6, total assets of all billionaires included in the list were estimated at 29.5 billion dollars. In the evening, the amount decreased by 1.25 billion dollars. But it was a serious blow to all Russian business; the country's 50 richest men (according to the Forbes' annual billionaires list) lost more than 12 billion dollars. On April 9, the capitalization of the Russian stock market shrunk by 7% (over

banks, fell 16 percent, which is comparable to the Nor Nickel's loss. One of Russia's leading mining and metals companies Mechel lost 17 percent of its value. Russia's biggest gold producer Polyus Gold lost as much as 26 percent. The steel company Evraz crashed 8 percent in London, where the company is listed.

Undoubtedly, it was Oleg Deripaska who suffered the most considerable losses. The U.S. Treasury justified that its authorities suspected the oligarch of money laundering, cheating his business associates, eavesdropping phones of governments officials, participating in extortion, bribing members of the Russian government, arranging a series of contract murder of businessmen as well as it indicated Mr Deripaska's links to organised crime in Russia. The Americans imposed sanctions not only on Mr Deripaska, but also on eight related entities, including Rusal (accounting for 7 percent of global aluminum extraction) and En+. Trading of En+ Group, which manages Mr Deripaska's assets, was temporarily halted in London after its shares lost almost one quarter of their value. On 9 April, aluminum giant United Co. Rusal PLC (currently listed on the Hong Kong stock exchange), which constitutes the heart of the Rural holding, lost a half of its value (3.5 billion euros). Since that time, the situation has only deteriorated. When the company announced that, due to the sanctions, it faced insolvency in the case of certain types of loan liabilities, such major investment banks as Goldman Sachs, UBS and JPMorgan started to sell Rusal's securities at 30-50 cents on the dollar. On April 16, Rusal shares fell to its historic low (0.21 dollars per share). This constitutes the worst result since 2010. The only solution to this challenge is to withdraw Mr Deripaska from Rusal and ask the Americans to remove

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the concern from the „blacklist”.

Hitting such tycoons as Mr Deripaska, Mr Vekselberg and Mr Kerimov constitutes a blatant signal for all Russian private businessmen that they can pay for Kremlin’s policy out of their own pocket even if they do not support it directly. Moreover, such a panic reaction of the Russian markets was quite surprising; it seems that Russia did not take too seriously the Putin list issued in January this year, even if the documents contained names of many businessmen who were seemingly not involved in the Kremlin’s malicious activities.

The American sanctions targeted to a great extent the companies that were active on international markets. However, they did not have any negative impact on the fortunes of two businessmen belonging to the so-called „Putin’s inner circle”, namely Igor Rotenberg and Kirill Shamalov. The sanctions will severely affect these companies that are listed on global stock exchanges and operate worldwide. These are oligarchs who do not belong to Putin’s inner circle. Possible consequences of the restrictions may be less strict for Mr Rotenberg and Mr Shamalov as they run their businesses mostly due to state contracts and are supported by state-owned banks. Among them, there are for example sanctioned entities controlled by Mr Rotenberg: NPV Engineering and Gazprom Bureniye (oil and gas drilling company). According to the CEO of the latter, the company has neither accounts nor assets in the United States and the European Union as they work mainly with Russian oil and gas companies and equipment suppliers. Also, personal sanctions against the heads of large state-owned entities (including VTB, Gazprom, Central Bank) do not affect the activity of the companies; instead,

they seem to worsen contacts with the entities.

HELPLESS RUSSIA

Russia was preparing for sanctions over the autumn. For example, the government adopted a special regulation that allowed any state-owned companies to conceal their contracting parties in the case of public purchases. By July 1, 2018, all tenders for purchases of the defence ministry, FSB and SVR will be carried out by a secret ballot. Russia’s Promsvyazbank, which had been taken over by the central bank, became special-purpose bank for serving military-industrial-complex businesses supplied by other state-owned banks. Judging by the market reactions after April 6, such a solution did not help much.

Russia’s reaction can be divided into two parts: (1) how to help sanctioned entities (2) how to „take revenge” on the Americans. Prime Minister Dmitry Medvedev on Monday ordered his government to draw up possible retaliatory steps. In his opinion, the U.S. sanctions are unacceptable and unlawful. Mr Medvedev also ordered the preparation of a government support program for targeted entities. At the same time, Russian authorities stayed calm. On April 10, the head of the Central Bank of Russia Elvira Nabiullina assured that there was no risk for the country’s financial stability and that Russia’s economy and financial sector would adapt to the new situation. On the same day, Mr Medvedev declared that the country’s economic situation was „absolutely stable” and that all macroeconomic indicators were at the correct level.

However, during the annual congress of the Russian Union of Industrialists and Entrepreneurs, Prime Minister stressed that Russia would support the companies on the

sanctions list. In order to achieve so, the state can offer contracts under preferential conditions; nonetheless, it is difficult to consider them as beneficial to the economy and its competitiveness. Tax reliefs may constitute a considerable loss for the state budget. And yet, Denis Manturov, Minister of Trade and Industry of the Russian Federation, announced that the sanctioned companies would be even more supported by the state. It seems to be obvious in the case of state-owned enterprises but what about private ones? It may be a fine way to their partial or even full nationalisation and large state-owned corporations may purchase shares of private companies that have been hit with the sanctions. Such a state of matters would be compliant with the regime's policy of increasing state participation and control over the economy since Mr Putin has long encourage the oligarchs to bring their capital to the country whereas the siloviki have promoted the model of state capitalism. Nonetheless, the strategy involves large expenditures and may appear to be risky as evidenced by the example of Rosneft whose authorities decided to buy, take over companies and invest huge amounts of loaned money. Tax reliefs, however, are quite costly for the budget. Russia's government was even mooting the creation of two tax havens located in Kaliningrad and Vladivostok. However, the idea is already doomed to failure since it will not be supported by Russian oligarchs targeted by Western sanctions.

In this context, Moscow will find it extremely difficult to take any economic revenge on Washington. The Russian authorities do not dispose of any tools to exert pressure on American companies since only a few of them are based in Russia. There is still the issue of some specific economic sectors in which Russia's cooperation with the United

States plays an important role. Such are the cases of Russian supplies of rocket engines for the NASA space program as well as the import of American technologies by some Russian enterprises. But any restrictions in these areas will only harm the Russian economy. Such gestures as the ban on the

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import of American wines, spirits and tobacco cannot be treated seriously. But the U.S. medical embargo may hit an average Russian patient. It does not come as surprise that the issue of so-called counter-sanctions has been transferred to the State Duma, which had no great political significance in Putin's regime. And the Kremlin is not in hurry to introduce any counter-sanctions. On April 16, members of the State Duma deferred the case: the first reading of the bill on retaliatory measures against US sanctions is scheduled for May 15. The draft law provides Russian authorities with the possibility to apply a total of 16 retaliatory actions, does not imply the introduction of immediate sanctions, but it contains proposals that will be available to President Putin. Nevertheless, the document does not oblige the president or the government to introduce all restrictions at the same time. The entire initiative is doomed to failure and has no real significance. However, Russian authorities have come up with another idea. On April 28, Russia's Prime Minister Dmitry Medvedev said that in response to the restrictions imposed by the Trump administration, Russia could possibly

introduce some individual sanctions against American citizens. However, the plan has not been developed since then. By the end of July, the State Duma may finalize work on the draft law on criminal liability for natural persons and fines for companies that will comply with the American sanctions in the territory of the Russian Federation. Such a venture, however, seems quite complicated.

FEAR OF THE FUTURE

Further consequences of the American sanctions will have both political and economic character. There is no doubt that Moscow is trying to make the best of a bad job. Interestingly enough, on April 10, the Russian Ministry of Finance has cancelled on Tuesday for the first time in 2.5 years, the issue of government bonds due to unfavorable market conditions. Sanctions will affect the economy in a considerable way, which cannot be compared with the previous restrictions. Economists of the Moscow School of Economy have already anticipated decreased rouble's exchange rate against the US dollar (by 4 rubles), slowdown in GDP growth (1.7 percent instead of the projected 1.9 percent) as well as acceleration in price growth. According to these estimates, at the end of the year, inflation may reach 4.1 – 4.3 percent, compared to the previously forecasted 3.6 percent. But the situation may change for the worse.

The Russian economy, which is based on the export of raw materials, is not threatened by a sudden fall due to the fact that the prices of hydrocarbons in the world remain stable with a slightly upward trend. They seem to protect the Russian currency against any strong exchange rate fluctuations; the sharp drop in the value of the rouble after the US sanctions will not affect Russia's economy to a large extent, said Alexei Kudrin, an

economic adviser to Mr Putin and a former finance minister on April 10. Now Russia's weakest point is the oil price. President Trump's tweet on April 20, in which he blamed OPEC for rising oil prices, must have caused panic in Moscow. Further sanctions may be introduced as a response to such actions as aiding President Bashar al-Assad in Syria's civil war. They may also target Russian sovereign debt; it is also said that the country may be excluded from the SWIFT system. The Americans may also target the largest Russian banks, such as Sberbank and VTB (both are currently subject to sectoral sanctions and have limited access to international credit markets). Their actual exclusion from international transactions would also mean a disaster for large Russian companies supported by their loans. The restrictions imposed by the Trump

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administration constitute a blatant message to the global business: if you cooperate with any Russian contractor, you risk too much. Sanctions can be extended at any time to affiliated companies; for example, they may possibly target banks that perform significant operations with the above-mentioned entities. Such a company will be no longer reliable for many suppliers, a significant part of the buyers as well as for banks and private investors. At best, Russian business will be subject to

onerous checks on every attempt to collect capital from abroad and, at the same time, it will be much more expensive to handle. In the worst case scenario, companies may be given a negative decision. Officially, restrictions covered specific entities and individuals; nevertheless, most Russian citizens will affect their negative results.

Firstly, the sanctions imposed by the Trump administration will influence the overall condition of the Russian economy. Secondly, they will have an impact on the relations between the oligarchs and the Kremlin. The regime may find it extremely difficult to compensate for any losses resulting from sanctions imposed on businessmen and their companies. The more so that Mr Rotenberg

and Mr Shamalov will be most eager to get some state money. They are then followed by Mr Miller and Mr Sechin as well as Mr Deripaska and Mr Kerimov at the very end of the list. Such a state affairs will probably result with increased tension between Russian businessmen and authorities. It is additionally fuelled by social dissatisfaction connected with negative consequences for the entire economy. Even such nationalisation and formal takeover of various companies by the state will not turn out to be successful in the long run. Instead, it will constitute a burden to the already tight budget and may eventually damage the competitiveness of the economy, and thus result with economic and financial crisis. Such a situation may be triggered by falling oil prices.

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