Congressional Research Service
Informing the legislative debate since 1914

IN FOCUS

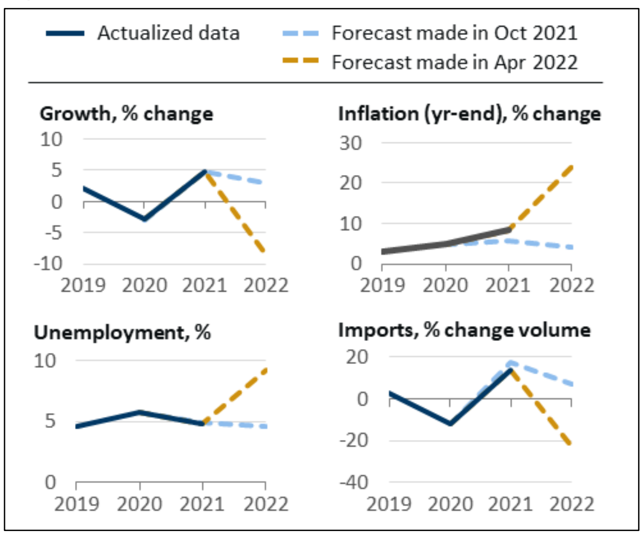
May 3, 2022

Russia's War on Ukraine: The Economic Impact of Sanctions

Impact on Russia's Economy

Across a range of metrics, Russia's economy is worse off than it was before Russia expanded its invasion of Ukraine in February 2022. The International Monetary Fund (IMF) projects that in 2022 Russia's economy will contract by 8.5%, inflation will reach 24%, and unemployment will double to 9.6% (**Figure 1**). The new sanctions imposed by the United States, the European Union (EU), the United Kingdom (UK), Canada, Australia, Japan, and others are unprecedented in terms of scope, coordination, and speed, and appear to be the overarching source of economic pressure on Russia. Other factors—including economic disruptions from the war and the pandemic—also are creating challenges. The Russian government has implemented a number of policies to mitigate the impact of sanctions, and Russia's energy exports—so far largely exempt from international sanctions—remain a major source of revenue.

Figure 1. IMF Forecasts for Russia



Source: Created by CRS from IMF World Economic Outlook Data.

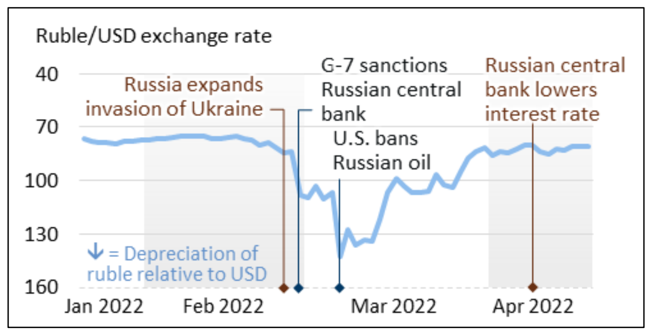
Financial Sector

Some of the most significant sanctions—those targeting the central bank and Russia's participation in the Society for Worldwide Interbank Financial Telecommunications (SWIFT) financial messaging system—created an immediate crisis in Russia's financial sector. The sanctions triggered runs on Russian banks, capital flight, and a 60% depreciation of the ruble in less than two weeks (**Figure 2**).

The Russian central bank responded quickly by imposing capital controls, doubling interest rates, and providing emergency liquidity support to banks. The government closed the stock market for a month and announced no new government borrowing through the end of the year. These policy actions stemmed capital flight and restored some stability. The ruble rebounded, reaching pre-war levels by late March (**Figure 2**). The central bank subsequently lowered interest rates slightly and somewhat relaxed capital controls.

Russia's financial stability is precarious. The ruble would almost certainly depreciate further if interest rates and capital controls were further relaxed, and Russia has defaulted on some of its debt for the first time since the 1917 Bolshevik Revolution. The Russian government is trying to boost demand for its currency by demanding payment for natural gas exports in rubles (with unclear exemptions), and Russia suspended gas supplies to Poland and Bulgaria after they refused.

Figure 2. Fluctuations in the Value of the Ruble



Source: Created by CRS using data from the *Wall Street Journal.*

Real Economy

Sanctions have disrupted Russia's real economy—the production, purchase, and flow of goods. The volume of Russia's trade has contracted sharply (Russia's imports by volume are forecast to fall by nearly 25% in 2022), and more than 750 international companies have curtailed operations in or with Russia. Many international companies have limited business with Russia beyond what is required legally by sanctions, most likely due to concerns about the prospect for future sanctions, threats of asset seizure by Russia, and reputational costs of continuing business in Russia.

Several Russian factories reportedly have suspended production because they cannot access the necessary foreign parts and supplies. Russian companies cannot access essential goods and services (such as computer software or audits by major western accounting firms), and Russian consumers cannot access popular international products (including many western luxury items). Some foreign firms are major employers in Russia, and their exit is a shock to Russia's labor market. Moscow's mayor estimates that 200,000 people in the city are at risk of losing their jobs as international companies exit.

The Russian government has enacted a number of policies to support domestic economic activity, as well as retaliate against sanctions. It has banned the export of more than 200 types of goods through the end of the year, established financial support mechanisms for some affected workers, and instituted price controls. Reportedly, the government is considering nationalizing the assets of foreign companies exiting Russia.

Russia's Main Defense: Energy Exports

Russia's main economic lifeline continues to be its energy exports, particularly to Europe. High energy prices and sharp contraction in imports have created historically high current account surpluses in Russia. The Institute of International Finance (IIF) estimates that (absent significant new sanctions on Russian energy) Russia's current account surplus could exceed $250 billion this year, allowing the government to replenish frozen central bank assets (around $300 billion).

Economic Impact Outside of Russia

Although sanctions are a foreign policy tool deployed in several contexts, the coordinated sanctions on Russia are particularly significant due to the size of Russia's economy—before the war, the 11th largest in the world—and Russia's integration in the global economy. In addition to oil and natural gas, Russia has been a key global supplier of several metals (titanium, aluminum, and nickel), chemical gases used in semiconductor production, wheat, and fertilizers, among other commodities. Many international firms had also established factories, joint ventures, and retail operations in Russia, and face losses as they exit the Russian market.

U.S. Economy

The United States has never had a substantial economic relationship with Russia. For example, Russia (and the USSR prior to 1992) has accounted for less than 2.25% of annual U.S. exports and imports since World War II. However, sanctions may have significant effects on specific U.S. companies and sectors engaged with Russia. For example, there may be concerns about the exposure of particular U.S. financial institutions to Russia, the availability of raw materials from markets outside of Russia, and the competitiveness of U.S. firms. The main impact on the U.S. economy to date has been higher gas prices, exacerbating inflation concerns in the United States.

Global Economy

Sanctions that isolate Russia are a shock to the global economy, which was still struggling to recover from the COVID-19 pandemic. The sanctions have likely contributed to disruptions in global supply chains, higher global commodity prices, and a slowdown in global economic growth. The IMF forecasts that global economic growth will slow from 6.1% in 2021 to 3.6% in 2022, but it is difficult to assess the effect of sanctions separate from other contemporaneous factors, including the war or COVID-19 related supply disruptions in China.

Within the coalition imposing sanctions, the EU has been Russia's strongest economic partner and faces the greatest potential economic disruption. Europe remains heavily dependent on energy imports from Russia, especially natural gas, and current EU sanctions on Russia include certain energy-related exemptions. The EU is considering new sanctions on Russian oil imports, but Germany, in particular, is reluctant to implement a full energy embargo, including on natural gas, which could reduce German GDP this year by 0.5% to 2.5%, according to most estimates. (By comparison, Ukraine's finance minister predicts that its GDP will contract by 40% in 2022.) Efforts to diversify energy sources are underway, but will take time.

In addition to energy exemptions, the sanctions also include exemptions to minimize humanitarian costs. For example, the sanctions exempt agricultural trade, because the war has disrupted global grain and fertilizer markets, increasing concerns about global food insecurity.

The sanctions on Russia are multilateral but not global, and Russia may seek deeper economic relationships with countries outside the sanctions coalition, including Brazil, China, Mexico, Saudi Arabia, and the United Arab Emirates, among others. It is unclear that Russia will be able to circumvent obstacles to cross-border payments created by the sanctions, or whether countries outside the sanctions coalition are willing to risk potential fallout with the United States, the EU, and others by increasing economic engagement with Russia.

Impact on the Structure of the Global Economy?

The new sanctions responding to Russia's aggression could have lasting effects on the structure of the global economy. The sanctions could create (or deepen) fractures in the global economy, resulting in disparate economic blocs and schisms that could undermine the international rules-based economic order that the United States has prioritized since World War II. On the other hand, a coalition of like-minded economies, led by the United States and Europe, could create opportunities for significant new economic agreements that have largely stalled in the World Trade Organization (WTO) over the past quarter of a century.

Sanctions could also accelerate efforts by various countries, particularly China, to reduce their reliance on the U.S. dollar in international transactions, and Western cross-border payments infrastructure more generally. The freeze of Russia's central bank assets, in particular, could make countries reconsider their holdings of and use of the dollar. There is some evidence that central banks are shifting out of U.S. dollar-denominated assets. If de-dollarization efforts gain traction on a broader scale, there would likely be implications for the U.S. economy and foreign policy.

Policy Questions for Congress

- Does international economic pressure influence decisionmaking in Russia?
- Under what conditions should sanctions be tightened, maintained (status quo), eased, or lifted?
- Should the United States seek to restrict Russia's access to proceeds of energy exports, such as through escrow accounts held outside of Russia?
- Should the U.S. government support U.S. firms and allies adversely affected by sanctions?
- How should the United States respond if countries outside the sanctions coalition increase economic engagement with Russia?
- Can the United States credibly assure other countries that their U.S.-based central bank assets will remain accessible during foreign policy disagreements?

Rebecca M. Nelson, Specialist in International Trade and Finance