Half-hearted sanctions against Russia have already failed

By Ambrose Evans-Pritchard

(Telegraph)

Russia has not defaulted on its sovereign debt after all. Nor is it likely to do so under the current sanctions regime, and as long as Europe continues to finance Vladimir Putin's military state with purchases of gas, oil, and coal.

The Kremlin is already sufficiently confident to reopen the Moscow stock exchange for bond transactions. The US Treasury's sanctions office (OFAC) has made life easier by leaving a loophole for sovereign debt repayments, concerned that there might otherwise be a Lehmanesque shock to global finance.

The uninterrupted flow of fossil revenues – at windfall prices – is enough to cover interest service costs and redemptions. Goldman Sachs even thinks that the central bank will be able to relax capital controls gradually.

The rouble has not collapsed. It has stabilised after a 40pc devaluation, a manageable drop for a semi-autarkic closed economy. The fall is less than the currency slide in Turkey over recent months, which few even noticed outside specialist circles.

We are facing the failure of western sanctions policy. Calibrated half-measures are not sufficient to change the Kremlin calculus or to dissuade Putin from a policy of attrition against civilian targets.

Yes, Russia is having to sell some crude oil at a steep discount but the gap is already narrowing as shippers learn to navigate the political reefs.

India and others are competing for bargain supplies, cutting the discount to $20 this week from $28 a barrel after the invasion of Ukraine. If Europe is still buying Russian oil, how can distant states in Asia be persuaded to desist?

The Kremlin is still earning almost $100 a barrel at today's global prices ($118), twice the average of the last eight years. The Russian current account is in rude good health. Clemens Grafe from Goldman Sachs expects the surplus to top $200bn this year as imports of western consumer goods are slashed.

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Russia has enough usable foreign currency to stay afloat for a long time. Western sanctions against the central bank are not proving to be the killer blow supposed at first, and nor is the ejection of some Russian banks from the SWIFT nexus of global payments. There are too many deliberate exemptions.

Goldman's deep-dive into the effect of sanctions ought to end all wishful thinking. The US investment bank forecasts that the Russian economy will contract by 10pc this year, a bad recession but not an economic breakdown. Growth will then recover to 2.4pc next year and 3.4pc in 2024 as the country adjusts. Exports will be back to 98pc of prior levels by early next year. If so, Putin is not going to lose sleep over this.

Russia's trade will mostly be diverted rather than destroyed. There may even be some short-term growth stimulus as Russia replaces western goods with home-made manufactures. Putin has been building a fortress economy ever since the annexation of Crimea. Net foreign funding is negligible. Total public debt is 18pc of GDP, one of the lowest ratios in the world.

Over four-fifths of GDP come from sectors that import just 15pc or less of their inputs, falling to 7pc in the mining industry. This is a radically different economic structure from western states such as Poland.

"If Russia were fully integrated into global supply chains, restrictions on imports and exports would be immediately destructive. However, Russia largely exports goods that are almost fully produced locally," said Mr Grafe.

Iran endured tougher sanctions without buckling. Cornell professor Nick Mulder, author of The Economic Weapon, said the country settled into a new equilibrium within a couple of months. "If Iran's experience is any guide, Russia will survive and return to lacklustre growth," he said.

"Historically, sanctions have hardly ever been successful in stopping wars," he said. A rare exception was the Balkan 'war of the stray dog' in 1925. Needless to say, Putin's war on Ukraine is not a border skirmish. It is a long-planned attempt to overturn the post-Cold War settlement and alter the world's balance of power.

European ministers once again grappled with a hydrocarbon embargo – the fifth package of sanctions – at an EU meeting on Monday. Once again the proposals ran into resistance from Germany, with Italy and others happy to tuck in behind.

There is a pervasive fear of a gilets jaunes uprising across Europe, a

suspicion that a fickle public will not tolerate a cost-of-living shock once the horrors of Ukraine lose their novelty on TV screens – but that is to abdicate leadership.

The business-as-usual lobbies in Germany have dusted down a catastrophe scenario known as Lükex 18, a report by the German civil defence agency (BBK) painting a portrait fit for Hieronymous Bosch of what might happen if gas supplies were ever cut off.

It is to throw sand in our eyes. We are already in late March. The winter is over and Europe will have enough gas to last deep into the late autumn. It has sufficient spare import capacity for liquefied natural gas to rebuild some of its depleted storage with shipments of LNG from the US and Qatar over the summer months.

Professor Moritz Schularick from Bonn University said an immediate halt to all purchases of Russian gas, oil, and coal, would cut German GDP by 3pc this year and cost around €120bn but is perfectly feasible. “The world wouldn’t end,” he said.

The possible measures are by now well known. Every one degree cut in home heating saves 10 billion cubic metres (BCM) of gas. If Europe dialled down from an average of 22 to 19 degrees, which happened in some states in the 1973 crisis, it could already cover one fifth of total Russian supply. Targeted sections of heavy industry can be rationed with a small loss of GDP.

As for oil, the International Energy Agency has just cut its forecast for global demand this year by 1.3m barrels a day (b/d). It has issued a 10-point plan for rapid cuts that could shave a use by a further 2.7m b/d without causing an economic crisis, chiefly by a string of temporary measures such as lowering speed limits by 10 km/h, car-free Sundays, and less air travel. Together these savings add up to 4m b/d, equal to most of Russia’s oil exports to Europe.

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The issue is no longer whether it can be done but whether Europe has the political courage to try. What is clear is that western sanctions policy is the worst of all worlds. We are suffering an energy shock that is further inflating Russia’s war-fighting revenues.

While it is hard to separate the effect of sanctions from war disruption and market psychology, the current situation is intolerable. We are allowing Putin to exploit Russia’s leverage as a full-spectrum commodity superpower.

The spot price for ammonia in Europe has risen sevenfold this year, deliberately pushed higher by a Kremlin ban on fertiliser exports that has no other purpose than causing maximum chaos and probably a global food shortage over the next year. Shortages of nickel, palladium, and other metals are becoming critical.

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It is a strategic imperative to bring this crisis to a head immediately by raising the ante. A total energy embargo would buttress the military resistance of the Ukrainian armed forces and test whether it is even possible for Putin to continue prosecuting a bungled invasion.

As matters now stand, the sanctions have failed to achieve anything. It is Ukrainian resistance, and military kit mostly provided by the Anglo-Saxon powers of Nato and frontline EU states, that have so far held the line. Core Europe has done little more than bleat on the margins.

The spontaneous willingness of European nations to welcome millions of refugees is marvellous – and the UK should drop its tone-deaf visa requirement immediately – but what is most needed is to confront the cause of this vast human convulsion.

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