

## Impact of sanctions against Russia on Azerbaijan and its consequences

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### Abstract

In this article, we discuss the impact of sanctions and embargoes imposed on Russia by the G7 countries and their allies on the region, and especially on Azerbaijan.

Speaking about the impact of the recent sanctions on the Russian economy, opponents say that the sanctions will not have a serious impact on the Russian economy, citing the fact that the Putin government has taken everything into account.

In this article, we try to prove what the Putin government has not taken into account and why the sanctions will have a serious impact on the Russian economy.

Keywords: sanctions, embargoes, economy of Russia, economy of Azerbaijan

First of all, let's present a summary of the renewed sanctions. According to the latest information, all strategic and export-oriented Russian companies, including enterprises in the Defense Industry, Roscosmos, the automotive industry, and the energy sector, have been banned from selling technological products, especially semiconductors. Germany has renounced Russian gas and coal and suspended the North Stream 2 project. The world's oil and gas giants, transnational corporations BP, Shell, and Exxon, have withdrawn from the Russian energy market. Correspondent accounts of all major Russian banks in the United States, the United Kingdom, the European Union, Canada, Japan, and Australia with up to 80 percent market share have been closed, removed from the interbank payment system SWIFT, and excluded from international settlements and currency conversion. About 60 percent of the assets<sup>1</sup> of the Central Bank of Russia have been frozen, and access to the remaining 40 percent has been restricted. Russian stock exchanges have suspended operations. The World Bank, the Organization for Economic Cooperation and Development, and other international financial institutions have suspended their programs in Russia. Targeted sanctions have been imposed on prominent representatives of the Russian business and political elite, more than 100 oligarchs. Assets of their companies have been frozen. The US Department of Justice has set up a working group to identify their

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<sup>1</sup> Assets include cash, reserves, receivables, short-term investments, and long-term funds (fixed assets, intangible assets, long-term investments, construction in progress), as well as property at the disposal of the enterprise.

expensive properties, luxury yachts, private jets, and bank deposits. Against the background of the rapid depreciation of the ruble, prices are constantly rising in the country. This is a brief overview of the current situation in Russia, and the near future looks more gloomy. Because, even if the war stops, sanctions will continue because sanctions are easy to apply, difficult to eliminate, and time-consuming.

The price of 1,000 cubic meters of gas in the European market has risen to \$ 1,600. In the world market, as of March 4, Brent oil price has risen more than 15 percent to \$ 110 a barrel, and the price for West Texas Intermediate (WTI) has become \$ 108.45. The main reason for the rise in prices was Russia's withdrawal from SWIFT. For this reason, in recent days, even though Russia offers oil cheaper than the market price, it faces the problem of sale, because the buyer has difficulty paying. According to Morgan Stanley forecasts, at this rate, the price of a barrel of oil on the world market in the second quarter will fluctuate between \$ 110-125, and according to Goldman Sachs forecasts, the average price of a barrel of oil can be \$ 115. Taking this into account, the OPEC+ countries met and agreed to increase production from April.

Apparently, a sectoral and targeted economic and financial war has begun against Russia. The sanctions have been joined by more than 140 countries, including the United States, Europe, the United Kingdom, Japan, South Korea, and Australia, and more than 10 international organizations.

The scope of sanctions against Russia is expanding, and we receive information about new sanctions every day. The country's export potential is already subject to full or partial restrictions on key products due to existing problems in the field of transportation and the breakdown of the supply chain. Russian ships are banned from entering most seaports, European and US airspace is closed to air transport, and highways are closed to trucks. Thousands of Russian ships were stranded in seaports. So far, no country in the world has faced sanctions and embargoes on this scale. As a result, there is no doubt that the current and future state of the Russian economy will deteriorate sharply, leading to a serious decline in the national economy, a significant decline in production, a rise in inflation, and job losses. Analysts predict that Russia's GDP will fall by 20 percent in the second quarter. There is no doubt that the sharp changes in the Russian economy will have a significant impact on the countries of the region, including Azerbaijan. First of all, let's look at the direct effects, the State Oil Fund of the Republic of Azerbaijan will be the most affected one in this direction. Because:

- 1) 0.6 percent of SOFAZ funds or 270,150,660 US dollars are in Russian rubles.

2) SOFAZ has invested \$ 500 million and acquired about 3% of the shares of VTB Bank of Russia.

3) SOFAZ owns Galereya Aktyor Business Centre, worth \$ 133 million and located at Tverskaya 16 in Moscow.

As can be seen, SOFAZ's investments in Russia have exceeded \$ 903 million. These investments are currently at risk, which will ultimately lead to exchange rate losses for SOFAZ, in other words, an increase in extra-budgetary expenditures, which will increase its foreign exchange earnings. Therefore, SOFAZ and other Azerbaijani government bodies must sell their assets before the economic catastrophe in Russia and withdraw their investments.

I would like to note that although the official exchange rate of the dollar has been set at 110 rubles in recent days, this is not the final rate, the ruble will continue to depreciate.

Apart from the State Oil Fund, if we take into account that Azerbaijan's main import partner is Russia, then the biggest impact will be on trade relations with this country. This effect will be twofold. So, a number of imported products are expected to become cheaper due to the devaluation of the ruble in the Russian market compared to similar goods imported from other countries. This increases the likelihood that Russian goods will be offered cheaper in the domestic market and stimulates imports of Azerbaijan from Russia. Those who export goods from Azerbaijan to Russia will face losses due to the sharp depreciation of the ruble against the manat, which will reduce the income of producers and exporters, especially in the non-oil sector, mainly in agriculture. Last year, Russia was Azerbaijan's first trade partner in imports with 17.2 percent and third in exports with 4.15 percent. So, Azerbaijan bought \$ 2.1 billion worth of goods from Russia in 2021 and sold \$ 920.8 million worth of goods on the Russian market. However, it should be noted that more than 95% of the goods sold in the Russian market were non-oil products. This means that problems with bank settlements with Russia, which is the traditional market of the non-oil sector, and the devaluation of the ruble this year could create serious difficulties for exporters.

One of the areas affected by the current and future situation in Russia will be remittances sent to the country by Azerbaijanis living there. It is estimated that about 2.5 million of our compatriots live in Russia. Azerbaijani labor migrants are key participants in the formation of household income in most districts of our country. Tensions in the Russian labor market, the decline and devaluation of incomes due to this, and the depreciation of the ruble will also lead to a reduction in remittances to

Azerbaijan. According to the Central Bank of Azerbaijan, in 2021, remittances from individuals reached \$ 1 billion 133 million. According to the report, this is 3.6 percent more than in 2020. According to the results for 9 months of 2021, about 60% of remittances fell to migrants living in Russia. This means that last year, remittances sent by migrants living in Russia by bank amounted to \$ 680 million. A sharp decline in this transfer is expected this year.

In addition, the situation in Russia as a whole will affect trade relations, investment cooperation, and transportation with the countries of the region, which will indirectly affect the economy of Azerbaijan. So, the situation in Russia may lead to an increase in China's influence in the region and a decrease in Turkey's. Turkey, which faced a current account deficit of \$ 14.5 billion in 2021, could be in a more difficult situation due to the decline in Russian tourists, as well as the deterioration of trade relations with Russia, as well as the weakening of Turkey's position in Russian markets.

Observations and analysis of the recent war in Ukraine and sanctions against Russia show that although discussions on the Ukraine crisis have been going on for months, the Putin government, as well as Western powers, have underestimated or miscalculated many points.

First, I think that the Putin government could not calculate the exact time of the war with Ukraine. They believed that the war would end in 2 days at the earliest and at 3 days at the latest. That's why there were campaigns in pro-government Russian television stations that Ukraine would surrender in 48 hours or 72 hours. The Putin government believed that in Ukraine, Russian troops would be greeted with flowers, as in Karabakh in 2020, as in South Ossetia and Abkhazia in 2008, and as in Crimea and Donbas in 2014. However, this did not happen. Russia's aggression against Ukraine was met with serious social, political, and military resistance both at home and abroad. Together with the army, the Ukrainian people also began to fight against the Russian army and show courage. In addition, the civilized world immediately came to the defense of Ukraine. On the contrary, the Kremlin was isolated, and airspace, land, and sea routes were closed for Russia. Today, thousands of Russian ships are stranded in various ports around the world, hundreds of Russian planes are stranded at airports, and tens of thousands of trucks are stranded on the roads.

Second, the Putin government had previously miscalculated China's position. They did not take into account that China is obliged to comply with sanctions and embargoes, even if it does not support Western sanctions. Because Chinese companies, which are mainly interested in trade and investment cooperation with the Western market, specifically with the G7 countries, do not intend to violate sanctions and pay large fines.

Third, the Putin government did not take into account the scale of sanctions against Russia and their impact. For example, the Putin government considered the expulsion of Russian banks from SWIFT and tried to create and develop the System for Transfer of Financial Messages (SPFS) in 2017, but did not take into account the freezing of the assets of the Central Bank of Russia. So, although Iranian banks were expelled from SWIFT before Russian banks, the assets of the Central Bank of any country have not been frozen so far. However, the Putin government did not even expect Russia's major banks to be expelled from SWIFT because it was aware of the hesitations of Germany, Italy, and the United States. However, as if Russia's expulsion from SWIFT is not enough, the subsequent freezing of the assets of the Central Bank quickly weakened and paralyzed the strongest part of the Russian financial system. So, 60 percent of the foreign exchange reserves of Russia, the world's fourth-largest country in terms of foreign exchange and gold reserves, were sanctioned and frozen in a short time. Although the country's \$ 132 billion in gold and \$ 30 billion in foreign currency in the SDR, the unit of account of the IMF, remained outside the sanctions, there were difficulties in using them directly. Thus, as a result of unprecedented sanctions against the Central Bank of Russia, The Russian ruble has officially depreciated by up to 40 percent against the US dollar since the start of the war.

Fourth, one of the things that were not taken into account in advance was the suspension of the North Stream 2 project. So, despite the toughest pressures during the Trump administration, Germany had been absent from these pressures; however, it easily decided to apply a sanction when Russia's aggression against Ukraine started. Thus, as an operator of the Nord Stream 2 project worth \$ 11.6 billion, Gazprom's subsidiary, which has invested about half of that cost, went bankrupt in a few days.

Fifth, the Putin government did not expect a large number of individuals and legal entities to be targeted. More than 600 individuals and legal entities with assets of hundreds of billions of dollars, including Russian President Vladimir Putin and Foreign Minister Sergey Lavrov, are currently on the sanctions list. Furthermore, the losses due to the devaluation of their securities are estimated at tens of billions of dollars. So, during the resumption of sales the next day on the stock exchanges, which closed on the first day of the war, there was a sharp decline in stock prices. As a result, the ruble index of the Moscow Exchange fell by 45.3 percent to 1,684.95 points, the dollar RTS fell by 49.25 percent to 611.12 points. Although there was a partial return as a result of the auctions, the decline was still 33.3 percent in the Moscow Exchange Index and 39.4 percent in the RTS. This is the largest decline in the history of the Russian market since October 28, 1997.

The leading companies in the decline in share prices were Tinkoff Group (- 47.3 percent), Sberbank (- 43.6 percent), Rosneft (- 43.2 percent), VTB (- 42.5 percent), InterRAO (- 37.2 percent), Yandex (- 37.1 percent). Quotes on foreign websites, where some Russian securities are sold, have fallen even more.

According to Bloomberg, the fall of stock exchanges in Russia on February 24 was the third-largest decline in the history of stock exchanges. It lags behind only the collapse of the Argentine market in 1990 and the collapse of the Kazakhstan market in 2002.

All this has led to divisions among the business and media elites, who have suffered losses and most of whose assets have been frozen. Russian oligarchs Mikhail Fridman, owner of Alpha Group, and Oleg Deripaska, owner of RUSAL, protested against the war, confirming the allegations in response to an information request from the Financial Times and Reuters.

Sixth, technological sanctions were not taken into account. The subjects of this sanction are Russian Railways, Sovcomflot, United Shipbuilding Corporation, Kamaz, Sirius OJSC, Stankoinstrument OJSC, Khimkompozit OJSC, Kalashnikov Concern, Tula Arms Plant, NPK Engineering Technology, High Precision Complexes OJSC, Almaz-Antey Concern, Admiraltyyar, Alexander Research Institute of Technology NITI, Argut LLC, Novorossiysk, Rostec and Sevmash ports, as well as Russia special flight crew of the Presidential Administration of the Russian Federation, Progress Rocket Space Center, Forensic Center of the Ministry of Internal Affairs in Nizhny Novgorod, Irkut Corporation, Komsomolsk-on-Amur Aircraft Plant (KnAAPO, manufacturer of SU aircraft), Moscow Institute of Physics and Technology, Promtech-Dubna, Rosoboronexport, Oboronprom United Industrial Corporation, Rostec, Russian Aviation Corporation MiG, Sukhoi Civil Aircraft, JSC Tupolev, UEC Saturn, United Aircraft Corporation, United Engine Corporation, United Instrument Corporation, Sevmash, and Uralvagonzavod. The new sanctions ban the import of technology needed for their production and repair facilities.

Finally, the Putin government did not anticipate that transnational corporations such as BP and Shell would withdraw from the Russian energy market. Their withdrawal from Russia's oil and gas projects means that the need for modern equipment and technology in the sector will not be met. This suggests that a number of oil and gas projects planned by the Putin government in this sector will not materialize.

Thus, it can be said that the calculations that the Putin government did not take into account or made a mistake have caused serious problems, especially in the Russian economy. Over time, the negative effects of these problems will be felt more in the activities of businesses and in the daily lives of consumers, i.e. the population. This will lead to a decline in the expected economic growth rate in the country compared to last year, a decline in budget revenue forecasts, and difficulties in fulfilling the state's social obligations. This negative trend will be exacerbated by rising prices and lost jobs.