

The Ukraine Crisis and Possible Sanctions Against the Bank of Russia

Briefing note

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The likelihood of a military aggression of Russia against Ukraine, and potentially other targets, is growing daily. Beyond discussions about adequate diplomatic and eventually military means to counter a potential Russian incursion, the discussions about the suitability of economic sanctions to deter Russia from further escalating the already tense situation in Eastern Europe, or to implement them should Moscow take military action, has gained significant traction. Various options have been thrown into the conversation, including cutting Russia off from the SWIFT global payment system or cutting back gas imports, most notably by preventing Nord Stream 2 to begin operating.

An additional component of a Western sanctions policy could be blocking the financial assets the Government of the Russian Federation holds abroad. Such a move could have significant consequences for the Russian banking system and the overall state of the Russian economy. Though this might not be sufficient to deter Moscow from military action against Ukraine, it is likely to be a necessary component of a more forceful reaction. It would constitute a substantial escalation and potential end point of a targeted financial sanctions campaign, though needs to be embedded in a wider sanctions strategy. Western governments have repeatedly claimed that Russia would pay a “high price” if it took military action against Ukraine. Effectively freezing the financial assets the Russian Federation holds offshore might be part of the price Western governments have in mind. Such action would target the assets of the Bank of Russia, the central bank of the Russian Federation, including those of the National Wealth Fund, the stabilization fund of the Russian Federation operated by the Ministry of Finance and used to stabilize the Russian economy in times of distress.¹

We estimate that the Bank of Russia’s holds 622.3 billion USD in foreign currency and gold assets as of early January 2022. These include assets we estimate to be worth 128.3 billion USD held in an account of the National Wealth Fund, the stabilization fund of the Russian government operated by the Russian Ministry of Finance. Of that total amount, we believe that 278.2 billion USD are within the reach of an action by the U.S., Western European governments (Germany, France, the United Kingdom, and Austria) and Japan blocking the foreign currency assets of the Bank of Russia.

¹ The Bank of Russia and the National Wealth Fund are already in the crosshairs of U.S. authorities. In April 2021, the Office of Foreign Asset Control (OFAC) determined that U.S. financial institutions would be prohibited to participate in the primary market for ruble or non-ruble denominated bonds issued after June 2021 by the Bank of Russia, the National Wealth Fund or the Ministry of Finance or lending ruble or non-ruble denominated funds to them. All other activities involving their property or interests in property are still permitted. Department of the Treasury, Office of Foreign Asset Control. *Directive 1 under Executive Order of April 15, 2021, Blocking Property with Respect to Specified Harmful Foreign Activities of the Government of the Russian Federation.* <https://home.treasury.gov/system/files/126/sovereign_debt_prohibition_directive_1.pdf>, accessed 27 January 2022. See also Executive Order 14024 of 15 April 2021. Blocking Property with Respect to Specified Harmful Foreign Activities of the Government of the Russian Federation. <<https://www.federalregister.gov/documents/2021/04/19/2021-08098/blocking-property-with-respect-to-specified-harmful-foreign-activities-of-the-government-of-the->>, accessed 27 January 2022.

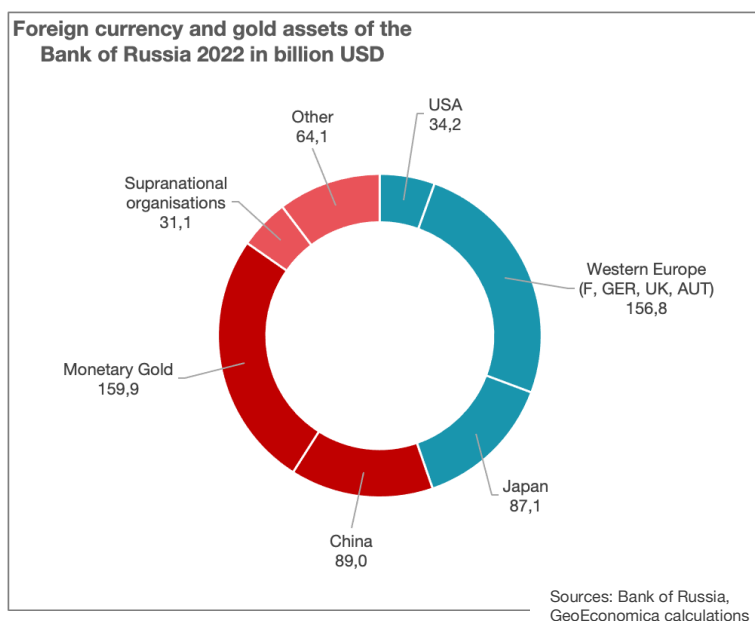
This hypothesis is based on the following analysis.

We assume that the Bank of Russia’s foreign currency and gold assets have increased by 5.8 percent from 588.0 billion USD on 31 December 2020 to 622.3 billion USD early 2022.² We also assume that the Bank’s balance sheet includes 65 percent of the NWF’s assets, amounting to 128.3 billion USD or somewhat more than 8 percent of Russia’s GDP.³

The Bank reports the geographical distribution of foreign currency and gold assets. That distribution is based on the location (place of registration) of legal entities which are the Bank of Russia’s counterparties or foreign issuers of securities.⁴

As of early 2022, we believe that assets worth 344.1 billion USD of the total of 622.3 billion USD foreign currency and gold assets of the Bank of Russia are likely to be outside the direct reach of Western and Japan government sanctions. The Bank reports that the gold assets it holds are stored in the territory of the Russian Federation⁵ and as such outside the jurisdiction of a foreign, and

potentially hostile power. We assume that the value of its gold holdings has increased from 137.1 billion USD at the end of 2020⁶ to 159.9 billion USD by early 2022 (which might be a little high). Assets worth 89.0 billion USD (up from 83.5 billion USD in 2021) or 14.3 percent of its assets are managed involving counterparties registered in China or are issued by Chinese entities.⁷ It is unlikely that the government of China would support sanctions against the Bank and these assets becoming direct targets



in consequence. The geographic exposure of roughly 10 percent of the Bank’s foreign currency and gold assets, we estimate to be worth 64.1 billion USD, cannot be determined.⁸ 5.0 percent of the Bank’s assets, we estimate to be worth 31.1 billion USD, are committed to supranational institutions. This, however, is not to say that these assets would remain unaffected if the Bank became a target of sanctions. Western governments could clearly make sure that trading in these would be prevented or at least inhibited.

² Bank of Russia. *Annual Report for 2020*, p. 99.

³ Extrapolating from Bank of Russia Annual Report for 2020, p. 39/40. See also an update by the Bank of Russia, documenting figures from 30 June 2021, largely consistent with our projections. https://www.cbr.ru/Collection/Collection/File/39684/2022-01_res.pdf

⁴ The geographic distribution of foreign currency assets is based on the location (place of registration) of legal entities which are the Bank of Russia’s counterparties or foreign issuers of securities. Bank of Russia. *Annual Report for 2020*, p. 100.

⁵ Bank of Russia. *Annual Report for 2020*, p. 99.

⁶ Bank of Russia. *Annual Report for 2020*, p. 99.

⁷ Bank of Russia. *Annual Report for 2020*, p. 100.

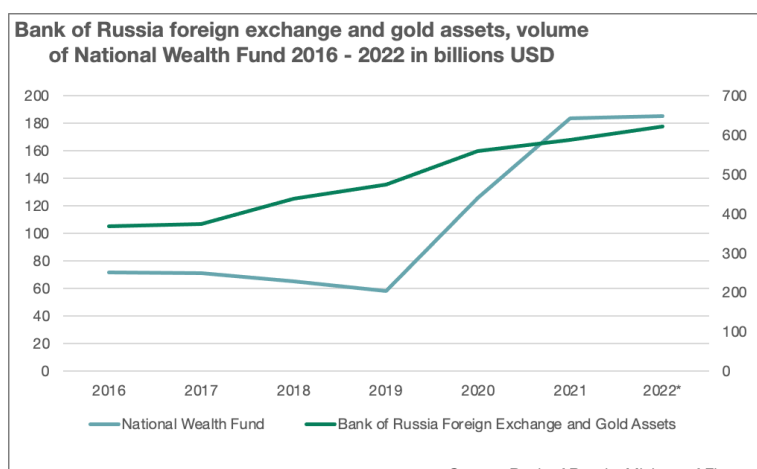
⁸ The Bank reports these as “Other”, see Bank of Russia. *Annual Report for 2020*, p. 100.

Regardless, this leaves an estimated foreign currency reserve worth 278.2 billion USD within the jurisdiction of the U.S., Western European countries (France, Germany, the United Kingdom, Austria) and Japan. Note again that the funds held by the NWF in the accounts of the Bank of Russia are included in the overall amount of foreign currency and gold assets held by the Bank.⁹

To put the amount of 278.2 billion USD into perspective: it represents roughly 90 percent of the value of all imports of goods and services of the Russian Federation in 2020 (305.0 billion USD),¹⁰ more than double the value of Russian oil and gas revenues in 2021 (119 billion USD), or five times Russia’s pipeline natural gas revenues (54.2 billion USD).¹¹

Some additional observations place these figures into context. (i) The reserves of the Bank of Russia increased quite substantially over the past years. (ii) At the same time, in anticipation of a major conflict with the U.S. and its allies, the Bank has proactively rebalanced the geographic exposure of its portfolio away from Western jurisdictions (and in particular the U.S. and the USD) and towards gold and China. (iii) The National Wealth Fund has been an important instrument for the Russian government to shield the Russian economy against external risks, including geopolitical ones.

With 68.9 percent, the value of the reserves of the Russian Federation increased significantly over the past five, six years from 368.4 billion USD in 2016 to 588.0 billion USD in 2021 and our



Source: Bank of Russia, Ministry of Finance
* GeoEconomica calculations for BoR

estimate of 622.3 billion USD in 2022. One of the main contributing factors has been the increase of the value of the assets held by the NWF. After having stagnated for some time, the value of the NWF’s assets increased from 58.1 billion USD in 2019 to 183.4 billion USD by early 2021 and stands at 182.6 billion USD, or 13’565.4 rubles in January 2022.¹² This surge has been driven by the substantial oil and gas revenues generated due to

elevated market prices during the past two years, and a modification of Russia’s fiscal rule which stipulates that excess fiscal revenues are to be saved in the NWF.¹³ It is important to note, again, that only the liquid assets of the NWF, we assume to amount to 128.3 billion USD in January 2022, are stored at the Bank of Russia and are part of its balance sheet. The other financial assets of the Fund are largely invested in domestic strategic assets (see below).

⁹ See Bank of Russia, *Annual Report for 2020, Annual Balance Sheet as of 31 December 2020, Liabilities, 2.1. Federal government funds*, p. 253. See also p. 280 for further clarifications.

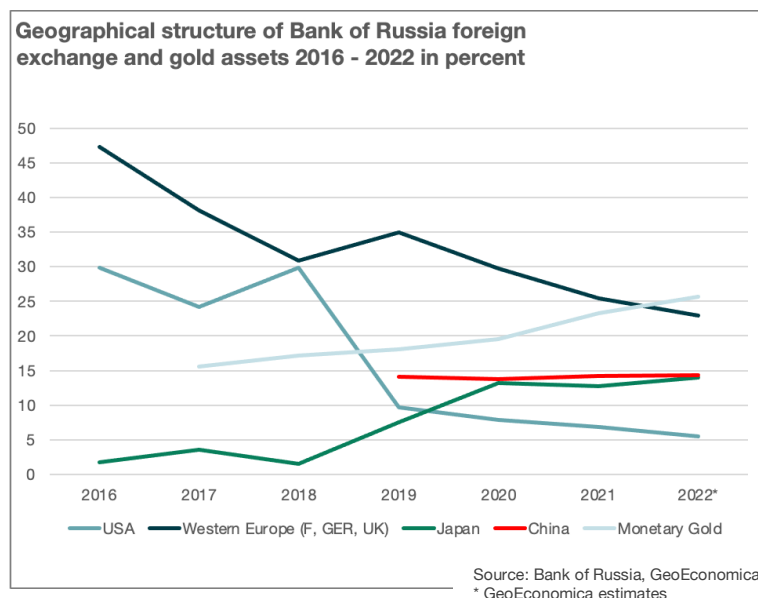
¹⁰ World Bank. *Imports of goods and services (current US\$) – Russian Federation*, accessed 24 January 2022. <<https://data.worldbank.org/indicator/NE.IMP.GNFS.CD?locations=RU>> The Bank claims that the amount of Russia’s international reserves is sufficient to finance goods and services imports for 23 months. Bank of Russia. *Annual Report for 2020*, p. 45.

¹¹ Reuters. *Factbox: Russia’s Oil and Gas revenue Windfall*. 21 January 2022.

¹² Ministry of Finance. *Volume of the National Wealth Fund* https://minfin.gov.ru/en/key/nationalwealthfund/statistics/?id_65=104686-volume_of_the_national_wealth_fund, accessed 25 January 2022.

¹³ See also International Monetary Fund. *Russian Federation, 2018 Article IV Consultation*. September 2018.

Over the past few years, the Bank of Russia has diversified its foreign exchange reserve portfolio away from the Western hemisphere. Ten years ago, over 90 percent of the Bank’s foreign exchange reserves involved Western counterparties or issuers of securities.¹⁴ This has changed dramatically over the past few years. Today, we estimate that only 44.7 percent, perhaps a little less, of the Bank’s assets are invested in securities issued by or located in countries of the Western hemisphere and Japan. The drop of the Bank’s geographic exposure to the U.S. from 29.9 to 9.7



percent between 2018 and 2019 has been particularly significant. Russian holdings of U.S. Treasury securities declined by 84 percentage points between March and May 2018, falling from 96.1 billion USD to 14.9 billion USD, triggered by the sanctions campaign of the U.S. in response to Russia’s hostile actions against Ukraine in 2014 and the alleged meddling of Moscow in the 2016 U.S. presidential elections.¹⁵

That said, the Bank also cut its exposure to Western European (most notably France, Germany, United Kingdom) securities or counterparties nearly into half. Interestingly, the Bank placed significant trust into Japanese counterparties and securities and increased its geographic exposure from 1.5 percent in 2018 to 12.7 percent in 2021 and an estimated 14 percent in 2022.

As the Bank moved away from Western assets and counterparties, it moved into gold and China. By 2011 the share of gold in its international reserve portfolio amounted to 9.0 percent. Gold holdings increased significantly over the past ten years and reached 23.3 percent in 2021 and an estimated 25.7 percent in 2022 (which might be a high estimate). With an estimated 14.3 percent, the Bank seeks to grow the portfolio’s exposure to Chinese assets and counterparties - a policy that has gained renewed traction in mid 2021, when the Russian Finance Minister Anton Siluanov announced that the NWF would completely divest 41 billion USD, representing 35 percent of the NWF’s total assets, within a month and turn towards euros, the Chinese yuan and gold.¹⁶

The third observation this note wants to stress is that the purpose of the NWF over the past few years has significantly changed. The original objective of the NWF has been to co-finance Russia’s voluntary pension savings scheme and to balance the budget of the Russian Federation’s Pension Fund. Yet, in line with legislation passed in 2017, and after being merged with the depleted Reserve Fund, the NWF is used to accumulate excess revenues from Russia’s hydrocarbons exports

¹⁴ Bank of Russia. *Annual Report for 2011*, p. 80.

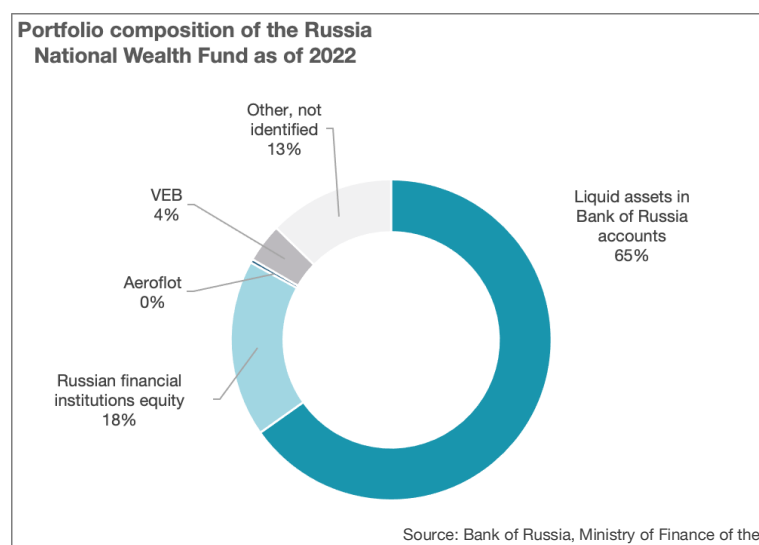
¹⁵ CNBC. *Treasury Data Shows Russian Holdings in US Debt Plunged 84% since March*. 29 July 2018.

¹⁶ Moscow Times. *Russia to Ditch Dollar from \$185Bln Reserve Fund*. 3 June 2021. <https://www.themoscowtimes.com/2021/06/03/russia-to-ditch-dollar-from-185bln-reserve-fund-a74098>.

and to cover a government budget deficit in case of a shortfall in oil and gas revenues.¹⁷ Also, assets held beyond those at the Bank of Russia can be invested elsewhere, provided that their value does not fall below 7 percent of GDP. As mentioned above, in January 2022 we assume these to amount to 128.3 billion USD or about 8 percent of GDP.

Already before this legislation was passed, the NFW provided liquidity support and capital injections to the Russian banking system and other financial stimulus supporting the Russian economy. During the Ukraine crisis of 2014, when the U.S. and other Western actors placed sanctions on Russian financial institutions, including Sberbank, VTB Bank, Gazprombank and the Russia Agricultural Bank (Rosselkhozbank),¹⁸ the NFW intervened in September 2014 by investing 214 billion rubles in equities

of the VTB Bank, 25 billion rubles in the Russian Agricultural Bank in October 2014 and 39.9 billion rubles in Gazprombank.¹⁹ The total investment of 279.0 billion rubles into these three financial institutions represents roughly two percent of the NFW's total assets.



During the Covid-19 crisis in 2020, the government decided to invest 2'139 billion rubles in Sberbank shares and 50 billion rubles in the shares of the

aviation company Aeroflot,²⁰ together amounting to another 15.7 percent of the NFW's assets. In addition to these, the NFW participated in a capital increase of VEB, the Russian state development corporation, with 531.2 billion rubles, or 3.8 percent of its assets, engaged in a loans program to small and medium sized Russian companies via VEB and contributed to its other development projects.²¹ Over time, the NFW's total amount of domestic strategic investments has likely reached 38 percent of its total assets.

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¹⁷ See also IMF. *Russian Federation, 2018 Article IV Consultation*. September 29, 2018. See also GeoEconomica. *Santiago Compliance Index, National Wealth Fund, Russia*. 2014.

¹⁸ Congressional Research Service. *U.S. Sanctions on Russia updated January 17, 2020*.

¹⁹ Russia Ministry of Finance. *Allocation of National Wealth Fund's Assets to Preferred Equities of Russian Banks as of 1 December 2021*. https://minfin.gov.ru/en/key/nationalwealthfund/statistics/?id_65=104304-allocation_of_national_wealth_funds_assets_to_preferred_equities_of_russian_banks_as_of_1_december_2021 accessed 24 January 2022.

²⁰ Bank of Russia. *Annual Report for 2020*, p. 39.

²¹ Ministry of Finance. *Allocation of National Wealth Fund's Assets to Deposits in VEB.RF as of 1 December 2021*. https://minfin.gov.ru/en/key/nationalwealthfund/statistics/?id_65=114232-allocation_of_national_wealth_funds_assets_to_deposits_in_veb.rf_as_of_1_december_2021 accessed 24 January 2022.