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Sergei Guriev on the Implications of Sanctions on the Russian Economy

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Webinar Transcript

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Markus Brunnermeier: So welcome back everybody for another webinar organized by Princeton for everyone worldwide. We're very happy to have Sergei Guriev with us today, yes Sergei, good to see you. So today we will talk about the implications of the sanctions on the Russian economy, and Sergei and I, we agreed that we will start with a short moment of silence for all the suffering which is going on right now in Ukraine, so let's have a quiet moment. Thank you. Sergei is from Sciences Po, but he was a chief economist of the European Bank for Reconstruction Development, so it's a World Bank for Eastern Europe, and he was also director of the new economics school in Moscow, so is one of the leading experts on the Russian economy and he had to essentially flee Russia some years back, and so we're very grateful that he's taking the time to illuminate for us what's going on in Russia, and why how the sanctions will impact the Russian economy. I would like to give a few opening remarks just about sanctions, but I have to admit I'm not an expert, so I will just give you my comments and thoughts and raise a lot of questions. The first question is, you know what's about sanctions, what's the objective of sanction, is it like you want to achieve a policy u-turn or even a change in leadership, and who should we target? Should target Putin and his friends, or the oligarchs? Should we go after Leningrad, you know the golden visa and money laundering, should this be the target or you want to target the military elite, and we have a poll question on that or your target more the financial market and, more generally, the people and media and so forth. The second question is, we have a lot of sanctions and experience but typically it takes very long, a long time to be effective, think about apartheid in South Africa and all this, so timeframe is very long. And then there's the question whether there's some non-linearities in sanctions, so that small sanctions might not be so effective, but if you have large sanctions, it might work very differently, so much more radically. And we haven't really experienced some large sanctions, we are seeing now, or we will learn how effective they will be. So there might be a different experience we might learn from this but there's existing literature out there to get some lessons from that. Now the question is what you want to do with these sanctions, you might want to trigger a financial crisis or bank run, and sanctions essentially disconnect the foreign country from the financial markets or the real markets, the output markets. Then, if, for example, you can't convert the ruble into dollars anymore, even though supposedly in Russia you can still convert them into physical dollars, I was told there might be bank runs to withdraw the rubles and people will then use the rubles, fearing inflation to convert them into goods, which then leads to higher inflation. That might explain why the Russian Central Bank has actually imposed

already, or set a higher interest rate in order to counter this anticipated inflation. And, in general, the one aim could be for the sanctions to undermine the confidence in the financial system and then Russia will fight the other way in order to maintain the confidence in the system, but the sanctions essentially are very targeted to minimize the limit of inflows, and make it harder for people to bring resources to Russia. Of course, the countermeasure is to have capital controls, where you control what can be outflowing, that comes from the other side, so Putin's team will do that. And the question is, you know, how to— with this aim— how to maintain the confidence in the financial system, we will see whether it works or not. And, of course, there is how can you get some outflow, and people might try to get money out and what's interesting if you look at the recent developments, whether you know gold or bitcoin is a more better source to bring money out, so in a sense, we often think of a safe haven or a safe asset that gold could be a safe asset, but because what the West did, it was very it's very hard for the Central Bank of Russia to actually sell the gold, so they couldn't really use the gold in a safe asset, it all lives from retrading, that you can actually use it when there's a crisis. And it seems like bitcoin is more the way to go now, perhaps we can learn more how this is but what's interesting is that if you look at the gold price, which is the yellow line here and compare it with the with the blue line, which is a bitcoin price, it's in percentage changes, you can see, after the invasion, the gold price moved up a little bit, but it is the case that the bitcoin price moves much more dramatically, of course, it has a higher volatility more generally, but after people have realized school is not so useful if you can't really transact on them, the bitcoin actually took over as a flight to safety asset and yet still up in the air what to do.

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Markus Brunnermeier: But, more generally, we haven't seen any big cyber warfare yet and cyber attacks, but what's also striking is that apple pay and Google pay were shut down and you could see when people in Moscow want to use the metro, they couldn't use the apple and Google pay anymore, they had to convert back to cash so in the sense when the war starts cash is king off the wall, so we talked a lot about digital cash and cash going away, everything moving to digital money, but when it gets really tough, cash comes back and is actually much more robust or resilient in a sense than the digital forms of money, so perhaps we can attach upon on that too. Now in the long run there might be two outlooks that both look very grim, and I can see one outlook with Russia, essentially goes for autarky, so it actually has a huge current account surplus of about two and a billion dollars and they can just go back, reduce exports and they have no surplus anymore, but just like the Soviet Union for 70 years, be disconnected from the global economy. Instead of having communism, they had a market economy or direct market economy and they decoupled from the production process, and the question is how costly and painful will it be to decouple from the production process, international production. Just if you look, for example, at automobile production and Volkswaggen is producing in Russia, and I was told the value added is about 70% in Russia, so 30% comes from abroad, 70— and then the question is how easily can you replace this 30% to keep production going in Russia itself, to decouple. And what will be the outcome if you go that approach, for Ukraine, will it be occupied like Afghanistan was occupied in the 80s by the Soviet Union. The other long term outlook is that Russia and China cooperate, or China throws a lifeline, and instead of having the ruble connected to the dollar, they develop a liquid ruble-renminbi in the market. So then, the international transaction for China will be much more to have Russia go through China and there will be, instead of having the ruble and the dollar market there will be a ruble- renminbi market. And then the question is to what extent Chinese banks are willing to do that and to what extent the U.S. then will sanction the Chinese banks and put them on the SDN list. Well saying okay, we actually in the U.S. are sanctioning also the Chinese banks and and still will not do it. That's a big question, both routes are open, of course, Russia might be threatened by China as well, but there is a big role for China, it can play as a big mediator at this stage. The power

broker or peacemaker in Ukraine, I think it's probably our best hope at this stage. But, of course, China is not happy to approve of breakaway regions and sanction— essentially be happy with independent regions in their own country, because they have their own problems at home. But in the long run, you have as soon as Russia and the former Soviet republics around it, and you have a resource hungry China and there might be tensions coming on and old fears coming on on their own.

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Now let me just end with the implications for the global economy and emerging economies, how will this whole situation evolve for the emerging economies, in particular, what are the implications for Turkey, Pakistan, India and some African countries, which are very dependent on oil. They have already experienced huge inflation and are not very stable, this might derail them further. Are we seeing something of a replay of the 1978 Iranian oil supply shock. Will this be dramatic again? And that might then also feed back to the whole global economy and also to the advanced economies, then there's also the question about the former Soviet republics. What will be the tensions there, are there those who are aligned to Russia, will they be more aligned to Russia and attention to China as well. And you know the West was very much focused on the Baltic States and Ukraine, but more or less left the other Soviet republics in the Russian sphere. But in general the emerging markets at some point will have a choice between going to the West and China, and that's where the tension is actually coming much more dramatic. You can see all the good in the Security Council, United Security Council, India was abstaining in the vote, of course, India will suffer and other countries will suffer much from the higher price, and that will be much cuter considerations as well. Now let me go to the poll question Sergei put forward, and thank you for submitting your answers, so the first question is who should be targeted with the sanctions? The oligarchs, that's what 28% said, the military elites: 17%, but the majority actually said we should actually target the financial system so that's 51%, and only 4% said we should target this state media. About whether the West should introduce oil and gas embargoes, which was very costly for the West, especially in Europe. And 73% so almost three fourths of those participants said yes, only 27% said no, and, should the EU offer membership, do you claim yes, admit right away? 18% said this. Yes, start accessing negotiations right away, that's 39%, so you know that's almost 60% that said yes and immediately or with starting negotiations and about 42% not now, we need structural reforms in Ukraine first, and all this, that's 42%. So these are interesting results, what we're seeing here, so i'm looking forward to Sergei's talk. He will give us some background about the Russian economy that we can actually put this in a bigger picture and see how things are playing out, so thanks again Sergei, it's a pleasure to have you and we're looking forward to your expertise.

11:30

Sergei Guriev: I thank you very much Marcus for inviting me. It's a great honor and pleasure to speak at this webinar, I have participated as a listener in the previous editions and I can warn you right away that I don't have a rigorous analysis to present. I will show you some numbers and service some research, but we are in the middle of the storm and we don't really have a good understanding of what's going on, and I hope I'll be able to take take your questions, so I am very happy to accept this invitation, but I also have to warn you that it's not as scientifically grounded as other presenters in this great webinar. As we chatted before, it's also a very special place for me. I'm sorry I'm not here physically, we visited Princeton for a year 18 years ago, and our son was born there, and as a circle completes he's now 18 years old and he's applying for Princeton so thanks. Come back, but this time, unfortunately not not physically, so I will talk about this sad story, you can see my slides right Marcus? About the Russian economy, which is now going through a very difficult period, it's not comparable to human tragedy, which is now happening in Ukraine and yet, one of the things you have to bear in mind is that the

Russian economy was not doing well, even before, even before the crisis, before the war. So basically the growth started to slow down, right after the global financial crisis, and if you compare incomes in GDP today to the last three or four years, 2013, that's actually one year when Russia was classified as a high income economy. In neither before or after it was. So the growth rate in GDP in those years, even before Covid, was below 1% per year, which is of course not sufficient to catch up with neighboring countries, catch up with advanced economies. And the projection was it would continue to stagnate because the investment climate is not good, corruption's high. Commanding prices are dominated by the state or politically connected business people, economy's isolated from the global economy, so we shouldn't be surprised that GDP is not growing. One other thing which is interesting is that, even though GDP slowly grew, real incomes of Russian households are still below 2015 levels so growth in household incomes was actually negative in those years, and that explains in part, why Putin's popularity has come down and why he needs the geopolitical advantage. Markus mentioned current account surplus and deficit on average in those years, we are talking about capital outflow of 4% of GDP per year, some years much more, some years, much less. This is eventually the other side of the current account surplus, investment climate is bad, capital's leaving Russia so ruble is cheaper and therefore Russian exports are more competitive than other countries exports, and so we observe current account surplus. And another thing which I mentioned already about investment climate: investment is low, investment to GDP ratio has been stagnating at 28%, and given that GDP is not growing, investments are also not growing, so this is definitely not sufficient to restart growth. So this is kind of the sad part of the Russian economy, the stagnation. Something that we— with my co author Aleh Tsyvinski predicted about 10 years ago, the Russian Economy will enter in the 1980s scenario, something like the Soviet Union in the 1970s-1980s and sadly this is exactly what happened before the war. On the other hand, there is a positive sign, a robust macroeconomic framework, a balanced budget: actually Russia is now the only major economy post Covid that will have a budget surplus— well not anymore, but it was projected before the war— that the Russian budget will be balanced. Debt is low, sovereign debt is less than 20% of GDP, total external debt is low, about 30% of GDP, and currency reserves are bigger than the total external debt, including corporate and bank debt. They are 40% of GDP, so currency reserves are a big part of the story today because sanctions hit them exactly, and that was completely unexpected and unprecedented for such a big pile of cash to be frozen. Within these currency reserves, there is a minister finances currency deposit which is called national wellbeing— national welfare fund which accounts for 12% of GDP, this is kind of a rainy day fund built through accumulating oil revenues.

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Now, in 2014 the Russian Central Bank moved to modern inflation targeting and it works and it works reasonably well. In the year after Covid, or during Covid, inflation picked up a lot around the world, and so before the war inflation was at eight or 9% and the policy rate was nine and a half percent. The target is 4% and, if not for the war, I'm pretty confident that inflation would have come down to the target within a year or two. Overall, there is a lot of praise about monetary policy of the Russian central bank. There are other issues regarding prudential regulation which I'm happy to talk about but overall, if you think about the Russian macroeconomic framework it's absolutely textbook modern macroeconomic framework framework which used to work pretty well, especially if you compare it to an emerging market like Turkey, where the president doesn't believe in macroeconomic orthodoxy. and therefore you have inflation of 40 or 50% inflation. Anyway so just to show you this pre-war, IMF fiscal monitor data which shows you that Russian budget was projected to be in surplus in the years after Covid, and this is not what Europe or U.S. does because they think that it's time to support the economy, but Russian fiscal policy has always been conservative, and this is what a Russian Finance Minister wanted to do. Now, this is the chart that shows you the evolution of

Russian real incomes, the blue line shows you that there was phenomenal income growth even during the global financial crisis. That's when Russia spent some of the rainy day fund to support incomes, but then starting in 2013, income started to come down which creates a lot of happiness among the Russian population so...

Markus Brunnermeier: The correlation with the oil price must be extremely high.

Sergei Guriev: With GDP, yes, of course, yeah correlation with the GDP and oil prices are very high. Some of the revenues are sterilized through this fund. But still, there is a very high correlation of course. One of the things which I would mention is especially scary comparison with other emerging markets, so if you go back to 2013, China had 12% of global GDP now, it says 17. Russia had 3% of global GDP and now less than two, and India is of course outperforming Russia as well, and so the place of Russia in the world is shrinking, and one of the most interesting comparisons is with South Korea. Russia until the global financial crisis was growing pretty much like South Korea, 11 years earlier. And my wife, Ekaterina Zhuravskaya and myself, we actually wrote a paper where Russia is not South Korea and predicted that in Russia growth will slow down, because the world has issues of institutional quality and stuff like that. And that's exactly what happened, but the joke now goes that Putin decided that South Korea is not a good model of development and instead started creating North Korean institutions. So even that is not that pessimistic. Now, this is the most important statistic that Putin is tracking, which is his approval rating and you see that as growth is slowing down his approval rating was coming down from 80 to 60%, and that is not surprising because incomes were stagnating, not growing fast, not as fast as the first decade of this century.

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And then Crimea happened, which brought him up from 60 to 90%. I'm doing research on this stuff so I'm very happy to talk about how these things are measured, to what extent they represent the public opinion or not, but just— this is a statistic which everybody's watching in Russia, there are different versions of those ratings and I'm happy to talk about that as well, but just this jump was probably so large that even Putin himself doesn't expect, but again, this effect started to fade the way, then in 2018 Putin raised the retirement age, despite promises not to do so, the ranking started to decline, Covid was also quite costly at some point, but then Putin has done a major tightening of information sphere and so it's very hard to criticize Putin in this way. Anyway, coming back to sanctions, first and foremost, sanctions started in 2014. And until now there's been quite a few papers usually looking either at the firm level or at the market level using VR analysis and all these papers by academic economists, by IMF economists, give you a measure which is the total measure for several years, the total effect on GDP is one percentage point. Now by Russian standards it's not that little because average annual growth is one percentage point, but on the other hand, it's not a game changer, right, if you think about why the Russian economy has stagnated in those 10 years, sanctions are only a small part of the story. Oil price collapse in 2014 was a much bigger problem and of course this issue of institutions that I mentioned. Quality of institutions, domination of the State, oligarchs, and so on, that prevented good investment planning, so I should also mention counter-sanctions, because in 2014 the Russian Government issued a food embargo on Western countries in Europe and U.S. For good measure, I should say, they also sanction Norway, which, until then, did not join anti-Russian sanctions. They sanctioned Norway, because Norway exported salmon and Putin's friend produced salmon in Russia, so they sanctioned Norway, just to block exports of Norwegian salmon, and then Norway after that increased sanctions against Russia. So the cost of counter sanctions also is not that high, so there is a paper by two Russian economists, which finds that annual loss of consumer surplus is half a percentage point of GDP and, if you

look at the deadweight loss, the part that is not appropriated by producers and tax revenues in this day you only find 0.05 percentage points of GDP, deadweight loss (per year) every year this embargo is in place. So pre war sanctions were important but in terms of the big picture really not crucial. Now we move to sanctions, now, these are the ones that Markus was talking about so one of the things which I should mention: sanctions were priced in before the war, so once Putin started moving the troops in November, December, January, markets already were nervous and ruble last about 10% of its value and on top of that ruble denominated stock price lost about 20% so in total, if you if you hold the dollar denominated index, in dollars, you lose about 30%. And the government was preparing for new sanctions and the market and the government were debating if the West would go as far as switching Russia off SWIFT, the banking communication system that was supposed to be the strongest sanction that could be realized, but in reality, of course, sanctions went much, much further. So some things got total block in sanctions, like VTB but not Sberbank, so VTB is a number two bank, Sberbank is number one bank where half of the Russians have accounts and SWIFT is cut off for some banks, but not all, yet, but they're a comprehensive export control sanctions including technology, and that means no chips from U.S., no chips from Taiwan, no aircraft parts, no just aircraft selling aircraft to Russia, but also no parts for existing aircraft which means in three years in three weeks or three weeks no planes in Russia will function, except for Russian made planes, which are few and also unreliable.

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Software, if you have Russian co authors, that's probably not the biggest problem but dropbox will not function very soon. Markus mentioned the apple apple pay and Google pay, maybe zoom function, so all of this is going to be difficult. But, most importantly, sanctions against the Russian Central Bank, so Russian Central Bank has those results 40% of GDP, \$630 billion, one of the biggest piles of reserves in the world and about half of this pile is in western currencies: dollars, euros, yen, pounds, Swiss francs, so the 40%; about 40% is gold and yuan. We don't know exactly because information is only published a year after the fact, maybe much more is now in gold and yuan. What is important to Marcus mentioned is that since the Central Bank is under sanctions, it's very hard to sell this gold and very hard to sell this yuan and, because if you transact with the sanctioned entity, you can be sanctioned yourself. I'm now in France, we have a very large bank here called BNP paribas which broke American sanctions in the past and not transacting with Russian, but with Sudan and Iraq, I think, and was imposed fine of \$9 billion, so Chinese banks are acutely aware of this now what is going to happen.

Markus Brunnermeier: Sergei, can you tell us why this one bank was excluded? That's because what's special about that bank?

Sergei Guriev: Right, so I'll talk more about that later, but the current situation is such that they want to keep carve outs, for being able to export oil, until we get your audience, Markus, who voted to introduce oil embargo to run the world. Until the oil embargo is in place, somebody has to pay for oil which is not easy, because already now. OFAC, the American sanctions unit within the Treasury, actually tells American banks what they can pay and cannot pay for in oil exports, it is one of those things that is still allowed. And so they need to open the door for some, but there is also an issue that in sanctions, you also want to have a threat and Sberbank is a huge threat because it's indeed the bank, which is a backbone of the banking system in Russia, and VTB is a big bank, number two bank, but it's not as important. So they also didn't sanction all banks. They didn't sanction all banks, yes, go ahead.

Markus Brunnermeier: About the SWIFT, it is essentially just a messaging system or you can also do it with fax messages; do you think there's a way to get around that or how costly would this ultimately be to set up a fax communication system?

Sergei Guriev: It's actually an interesting question, so SWIFT didn't always exist, as you rightly said, banks use telexes and taxes. Now, Russia after 2014 started to build its own system. And so within Russia it kind of functions outside of Russia, I think if China helps Russia, it will somehow function, but we are not there yet, because some banks are not yet cut off from SWIFT okay. So this is not there, but among sanctions which have already happened in the long run, I would say, the most important things are the full exodus of investors and trade partners.

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So Finland stopped selling alcohol to Russia. Russia can produce its own vodka, but some people just love Finnish vodka. Ikea today announced that they will close their stores, which will also be an issue. Visa and MasterCard will exit and so on and so forth, but what is important, which is less clearly seen is I mentioned aircraft, but things like chips, microchips, all kinds of intermediate inputs, equipment, all of that means that a lot of Russian businesses will be in huge trouble. They will have to substitute with Chinese and Indian products, but of course the West is still the biggest technology leader. Now another thing which people don't talk about is a major outflow of human capital, everybody I know is trying to run away. And this is pretty scary. I didn't see that in 2014 there is, by the way, now a discussion that tomorrow, Russia will introduce martial law, which means people who are younger— men who are younger than 45 will not be allowed to leave, starting in the morning. So things like this, of course, encourage people to buy tickets now and run, so what is the immediate impact? Markus was talking about long term impact and the Soviet model or Iranian model. All these things destroy economic growth and we will see a recession this year, instead of growth of three or 4%, we'll see— right now, the existing forecasts predict a three and a half percent fallen GDP in 2022, but what is special about these sanctions is they already destroyed the financial system immediately. So sanctions were introduced, sanctions against the central bank were introduced on Saturday. Already during the weekend, the trading was at crazy rates and the Central Bank just didn't open the currency exchange on Monday. And the markets are still closed, maybe today or tomorrow, some stock markets will open, but when we think about what's going on in Central America, reduce barriers to capital currency controls so, for example, if I have money in Russia, I can transfer it to my bank account outside of Russia. If I'm an exporter I need to bring the 80% of my export revenues back and sell them within Russia, and the Central Bank said, we are sanctioned, we don't have dollars, we don't sell dollars in Russia, so all of that created this weird reality, where we don't actually know how valuable it is but over the counter markets suggests that it's 30% cheaper than on Friday, previous Friday. So that's where we are right now outside of Russia, the stock market continues to work and you know still prices cannot be zero so Gazprom and Sberbank shares in London are now worth one cent. So, because you cannot buy them for zero cents, it's really crazy, but this is where we are, you can buy Sberbank for less than half a year of its annual profit. Now another thing is because of these problems with carve out, we still don't know how easy it is to pay for oil. People in Moscow tell me that a lot of oil gets delivered, but the payments are delayed and so some people just don't want to touch Russian oil. We see an unprecedented discount of Russian oil euros, relative to brand, so things are quite strange.

Markus Brunnermeier: How much— the domestic financial markets, are they still working or not? And how important is the domestic financial market or is everything also shut down? If one Russian wants to sell a share to another Russian within Russia...

Sergei Guriev: You can do it over the counter in principle, but essentially Russia is now completely digital so I didn't think about this, but I think in principle you can sell a derivative on a share. I can write you an IOU, I promise you that you'll get the share when the markets reopen so that is, that is something that we can legally do of course.

33:28

Markus Brunnermeier: They have all these pictures from bank runs, so people withdrawing cash. Is this a problem, or the Central Bank is ready to have enough cash and restore ATMs and...

Sergei Guriev: So there are various reports, so some banks say there is only a limited amount, you can withdraw, some banks say we function normally, but you have to wait a few more days, so this is where we are, so we are still— the picture still not clear, but people, yes, people try to withdraw cash and try to find dollars and buy dollars, because over the counter markets work, of course. And the problem is that the official rate of the Central Bank is different from the over the counter market. It's still not a black market, it is legal to sell and buy dollars, what's illegal is to take them out of the country. And what I wanted to show is this CDS value chart, so Russia has a beautiful aicro framework, as I mentioned. Russian sovereign debt is low, and yet CDS doubled in the last week or so, and this is pretty crazy, and it's actually doubled the price before the hostilities, so before Putin started to move, it was actually four times cheaper than today. And part of that explanation is we don't know where the Russians will be able to pay the debt and we hear that Americans actually say yes, you can. So there are carve outs for sovereign debt payments. Americans are very clear that sanctions add them on at the moment, maybe tomorrow, things will change, but at the moment if you're a Western investor who holds the Russian debt and you get paid the coupon by your Ministry of Finance of Russia, by your counterpart, there is a special permission to receive this money. So this CDS price suggests that maybe markets are afraid of new sanctions. Maybe things will get much worse, but at the moment, we should assume that there will be carve outs for oil payments and debt payments, so I don't expect...

Markus Brunnermeier: So these bonds are U.S. dollar denominated or Russian?

Sergei Guriev: Yes, in principle, you can hold the dollar denominated once if you're a Russian and then American sanctions will probably not hurt you but what I'm talking about is if I'm an American bank, holding dollar denominated sovereign bonds. Without this carve out, I'm not allowed to receive money from it, right, because you're a sanctioned entity. So now there are these carve outs and if we don't have new sanctions, we should expect sovereign default because all the revenue is sufficient to pay the debt, especially even...

Markus Brunnermeier: What I'm struggling with, why should Russia pay back its debt? It can just say sorry, we are under sanctions, we don't pay back our debt and the only way of our current account surplus, so why do they need to pay it back?

Sergei Guriev: Well, Russia doesn't like default, it creates bad memories, but the debt is very small, so it's not it's not going to make a difference, but in principle rush already talking about nationalizations of foreign assets. So, for example, one of the issues that I mentioned was

aircraft, so one of the sanctions was that all aircraft be released to Russian airlines by Irish companies. The Irish company said sorry, no longer. We take those aircrafts back. The Russian government said these aircraft are physically in Russia and we'll probably take them from you.

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I'm not sure it's finalized, but this is very, very likely. This is not going to save Russia because, as I mentioned, these aircrafts will not be serviced, so they will stop flying soon, but that's where we are. Actually, part of the panic in the stock market in London is also that the Russian Government forbade foreign investors to sell the Russian assets and take money out of the country, so that's going in that direction. What do you think? You can think about this as a capital control, so maybe temporary, but this is where we are. So imports will collapse so the current account will be huge and there'll be enough money, without oil and gas embargo, Russian macro will come back to normal. This normal will have a much cheaper ruble, we don't know by how much cheaper. The quality of technology will be much lower so growth will be slower, it will be negative this year, and we are talking about Soviet stagnation, Soviet decline probably. What happens if an oil embargo is introduced depends on China. Markus mentioned China, I would say the biggest question is if China joins or doesn't join the oil and gas embargo. If it doesn't join the oil and gas embargo, Russia will suffer because China usually loves to pay lower prices for Russian oil and gas. We don't know how much less. These are secret data, but sometimes China discloses it's a customs statistics and we can figure out that it is actually a substantial discount. But if China joins the embargo, then we are in completely uncharted territory in the sense that Russia's main source of oil and gas revenue— of dollars is cut off, and so we don't know we don't know what's going to happen. I expect there'll be something like an oil for medicine program because Russia imports a lot of medicine, half of the medicine's imported, and so I think the the community, the international community will probably try to help somehow— yeah, Marcus.

Markus Brunnermeier: So pretty much Russia is in the hands of China at this point. Does China want to have a weakened Russia or do they want to help them out? Do you have any sense, what will be going on there? Because essentially all technology can come from China as well, so if you need chips, you can get some you know, probably not the same quality as U.S. or Western chips, but you can get some good quality.

Sergei Guriev: That's absolutely true and that's exactly the big open question so that would be my last slide, but basically we don't know what changes things. China doesn't want war, as you rightly said, China doesn't want to break the countries territorial integrity, because China loves the idea that Taiwan is part of China and whoever wants independence of Donetsk coming tomorrow asks about the independence of Taipei. We don't know what China really thinks, but yes, weakened Russia is fully dependent on China. That's for sure, but the open war, destruction of a big country in Europe where China has a lot of economic interests is actually a shock to the European economy, which may be one percentage point or two percentage point of GDP of Europe, a very important market of China, so we are not sure, so let me just...

40:38

Markus Brunnermeier: If China says we are against war activities in Ukraine, and we also subsequently— the only option Russia has to go for is autarky, it will be very weakened and then, in the long run, China get cheap resources from Russia, it might be their interest to weaken Russia.

Sergei Guriev: Yes, that's correct, but if there is an oil embargo joined by China. China needs oil now, so you rightly said that we don't want an environment in which oil is \$150 per barrel, so the U.S. will be happy because the U.S. is now oil neutral. But China doesn't like \$150. So let me wrap up, I would just say that it's not just a dramatic economic shock, people are also leaving because freedom is shrinking every day and, as I said, tomorrow we'll probably see martial law or something like martial law. Today the last independent radio station was closed and the last independent TV channel— well it's not actually a TV channel— online TV channel was closed, and we should expect that access to YouTube will be closed very, very soon. So in terms of our book, I cannot miss this opportunity to promote our book published by Princeton University Press next month, so it's not just me it's also you. So in our book we discuss spin dictators and pure dictators, and Putin, who was based on the spin model, is now moving very quickly into the mass repression and in fear model. So these are the open questions that I wanted to leave on the screen, one is crypto: Markus mentioned crypto, so what I know I talked to people. I'm not a specialist, but definitely crypto will be enough to circumvent currency controls for individual Russians, so if you want to move several thousand dollars, you buy bitcoin here your friend has access to your bitcoin wallet in Europe, and so you can move this \$10,000, right away. Will it be enough to move \$10 billion? That's a different question and I don't think so, and my friends in the financial industry tell me that it's very unlikely that Russia will be able to do that. Now, you would ask me why Russia wouldn't ban Bitcoin. Actually Russia discussed that a couple weeks ago before the war and then the Central Bank was in favor of banning bitcoin for these reasons, while everybody else in the government said no, and the simple explanation is every government minister wants to move money across borders, his personal money so that is probably the best explanation. China, we talked about, I think, China will provide critical imports, will provide technology, will provide access to the payment system. There is an alternative scenario where China says no, we want to stop this war. If China says we want to stop this war, they can. I'm sure that if Mr. Xi calls Mr. Putin, Mr. Putin will somehow start invitations and now, something that we discussed in life without SWIFT, in principle, you can use the Russian substitute, which was built in the last few years, and it's not just fax or paper, it's a real electronic system, just very few banks have joined the system. There is also a Chinese system, so it's not that bad. And then there is also a Russian credit card system called Mir; Mir in Russia has two meanings, one is called world and the other one is called peace, so the wall for peace and for the world is the same, and they use it for Mir. And of course it's quite ironic because it's a war time card, and it also is not used in the world because it's used only in Russia. But there are substitutes and in that sense, I can imagine life without SWIFT, it just going to be very isolated autarkic life, so let me stop here, I took a lot of time, but they also answer some questions by Markus.

44:50

Markus Brunnermeier: So David Wilcox would like to know, can you discuss a little bit the self censoring by the Russians, so that they might actually decide not to export gas anymore, just to keep the gas price very high and also hurt or create a global financial crisis or global crisis for the rest of the world. Do you say this is possible?

Sergei Guriev: Yeah this is possible and Europe is actually preparing for this. Now there are discussions in Europe, can Europe survive the next winter without 50% of Russian gas or 100% of Russian gas, and these scenarios necessarily involve restarting some coal, necessarily involve a lot more nuclear, of course, so these are not pleasant scenarios and these scenario is also involved very high electricity prices so that should be a big fiscal support to households. So all of that is not pleasant, we saw reduced supplies by Gazprom this winter, even before the war. And so Gazprom said, we respect long term contracts, but we don't sell in the sports market. Even though the sport market prices were very high and every profit making company,

profit maximizing company would sell in this one market, Gazprom didn't want to do that, which suggests that there are some suspicious political reasons behind this decision, but in principle, so far we don't see that, but this is possible, this is this is possible, but I would think that Russia, first and foremost will nationalize stuff. That will be the first countersanction.

Markus Brunnermeier: And you don't have a take on how long it will take the rest of the world to scale up its gas and oil production like fracking in the U.S. or Saudi Arabia expanding.

Sergei Guriev: Saudi Arabia has an extra two or 3 million barrels per day, which is not enough to substitute Russia fully. So Russian gas exports are actually much smaller than Russian oil exports so for Russia, oil and oil products are much more important, two or three times more important depending on the day when— depends on the price of the day, and more importantly than gas exports. But Saudi Arabia can do more. If oil price stays at a hundred, fracking will expand really quickly that's for sure, but it's not yet enough so we'll see prices above hundred dollars. If Russia's out of the market, prices will remain very high for a while. And in terms of gas, Europe needs gas and so these gas will have to be rerouted from Asia, LNG formation, some from the U.S. so it's not none of that is going to be easy.

Markus Brunnermeier: So I was told you know, in the next few weeks it will be very decisive. Who is in charge is it more the economics team, or what the security minded team. Do you have a sense of this, you know who will be calling the shots essentially within Russia is it people who are more economically minded or people who are more much more security focused?

Sergei Guriev: There is no question about this, the country is now run by security people. Economics people are told you need to minimize the damage. It's very clear that economics people had no clue that the world would start. The worst scenario they were preparing for was a recognition of independent Donetsk and Luhansk people's Republic, and they were preparing for the SWIFT kind of sanctions at most and that's why reserves are so large. Russia thought that reserves would defend Russia but yes, that was destroyed, that the premise was dropped, but there is no doubt about this, but the economics team is competent and they will be able to minimize the damage and, as I said, I don't like Mr. Putin, and I think he is a war criminal, but if we want some dose of realism, right now, it doesn't look like the current level of sanctions will result in the macro economic collapse. It will result in a recession, quality of life will be very low, a lot of people will be unhappy, some businesses will just disappear, but it's not going to be 1991 with this level of sanctions. Now, new sanctions may come, but if they don't come I think the Russian macroeconomic team will regroup and in a few weeks, we'll see a much weaker ruble, maybe some currency controls will stay, maybe some capital controls will stay. But if Russia gets paid for oil and gas, there'll be even no sovereign default.

49:49

Markus Brunnermeier: So Sebastian Hohmann would like to know if you could design the sanctions, how would you design them, and you know what will be your target, in a sense. Are all the oligarchs influential? So if you target them, can they pressure the government somehow to go in a certain direction or it's hopeless or you have to go through making sure that the general population is— some are affected, and hence step to it like a democracy that would put pressure on the government. What will be your strategy in order— who do you have to hurt in order to make sure that there is some impact and, of course, going off the families of Putin and friends, and all this is one way to go, but how would you design it and make it more effective?

Sergei Guriev: So I should say that this question has been asked within Russia since 2014 and the Russian Government has prepared quite a bit for whatever the West is trying to do right now, and the sanctions on the Central Bank were very powerful and unexpected, but regarding the rest, the government was trying to prepare itself, so one of this is indeed destroying the link between unhappy population and policy change in democracy, populations unhappy, the leadership has to change behavior. In Russia, independent media and independent politics have all been suppressed, and the recent years, especially the last year actually. The opposition leader is in jail for a year now, Alexei Navalny, his team is almost fully out of the country, those who remain are also in jail. Independent media, as I mentioned, shut down so people will be unhappy, but that doesn't mean that Putin will change immediately. Oligarchs also have little impact, but all these things add up in the sense that if business elites are unhappy, if the public is unhappy, there'll be less and less money in the system and Putin will have to pay money to the soldiers and policemen to keep the population at home, so all these things add up for sure, it is just for now, whatever you do with the sanctions, I think oil embargo joined by China can be a game changer, without that I see that it's a huge economic shock and, as I mentioned, one of the forecast actually gives you minus 20% quarterly GDP in the second quarter, so that's a lot, but it's still not still not a macro economic meltdown.

Markus Brunnermeier: So, you mentioned the oil embargo would be a big hit, for you know, France, Germany, Europeans. and then also the U.S., and we should soften it by having some fiscal expansion. But what about the emerging economies: India, Pakistan, Turkey, what should we do with them, so let's suppose you're in the World Bank or the IMF, what will be your description to prepare these countries, emerging economies for some oil embargo, what measures...

52:53

Sergei Guriev: This is exactly the reason, they will not want to join the oil embargo, and so, gas and oil, as you know, are very different. Gas, especially pipeline gas, you only sell where the pipeline pipelines are but oil is completely fungible, and so you need the whole world to join the oil embargo and neither China or India have the interest to do that, and so the question is the will the West be able to convince China and India to do that, but yes, you need to provide the emergency fiscal assistance by the IMF to help those countries, because these countries are already hit by Covid. And then, as you know, unlike the advanced economies, they don't have that capacity. So for them it's much, much, much harder to handle shocks like this, so yeah that's for sure, you mentioned the oil price of \$150. You remember that oil price was 137 briefly in 2008 and then it collapsed. We don't know how the world functions with this price. 100, 110 we observed for quite a few years before 2014 so, but this is the price today, and so, if we have an oil embargo, the price is likely to be 150 dollars.

Markus Brunnermeier: But there are also some winners from this high oil price, in a sense, is there any way and if we have some global planners, we would have a global tax on the winners, or if windfall gains, and distributed to the losers.

Sergei Guriev: Some of the winners, you already tried to tax. Russia is also the winner from that instance.

Markus Brunnermeier: I understand Russia will be taxed, but the other one is like Saudi Arabia might be willing to or forced to. How about the rest of the world because it's not in the interest of either that the world economy collapses.

Sergei Guriev: Exactly no, I think if oil price stays very high, there'll be no spare capacity will be used, and of course us will try to convince its Middle Eastern allies to use all their oil capacity and strategic a lot reserves are being used, right now, as you know, so yeah people are worried about this alone.

Markus Brunnermeier: So let me— I know that you have a YouTube channel in Russian which I don't understand, which is all about after Putin. So, given the events which occurred now, do you think if ever Putin were to resign or will be removed, would Russia look very differently so let's suppose if you go to the autarky scenario, I think it seems like Russia might be very poor and will be not any major player anywhere in the future. Or, even if it goes in the China life saving scenario in both scenarios, Russia will in the long run be diminished, and this was any way before, it is the case now, it will be speeding the whole thing up or do you see like Putin a great Russia, Russia which he outlines in his speech, like how Hitler wrote Mein Kampf, outlined his vision, I think, Putin did the same thing, and I was told like you can download the speech from the Kremlin website.

56:00

Sergei Guriev: That's correct, it's actually quite striking, to what extent Putin follows Hitler's guidebook. It's pretty scary in a sense and one of the things on the emotional level— actually I used to live in Kiev, I have many friends in Kiev. But not just people in Kiev, but throughout Soviet Union, all this talk about 1941 when Germany bombed Kiev on the very first day, and so this one goes. June 22 at 4 am Kiev was bombed, we were told the work has started. This is exactly what happened on February 24 right, and so, and so these perils are huge, and so I think this is also what drives— for people in the U.S. people probably don't appreciate it, people in Europe see that as 1938 or 1939 and that's why the reaction is so strong in Europe. So talking about the possibility of post-Putin Russia, we don't know whether post-Putin Russia will be nice or not, but overall, we know that democratization is progression, yes, it comes in waves, today we are in democratic stagnation or recession, but the history so far is marching in direction, maybe China will change everything. Maybe China will build a new nice autocratic universe, and decoupled from the rest of the world, and will have clients like Russia. But so far, the history is very straightforward. Since the last 200 years we've had the signs of the democratic world increasing and the size of the autocratic world shrinking and it comes in waves. This wave is not there yet, but who knows. So I'm not. I'm not very pessimistic about the future of Russia, Russia is a very European country. Mentally, Russia is a very educated country, maybe a lot of educated people will leave, maybe a lot of pro European Russians will leave, but at the moment, things are— Russia is too modern to be a crony dictatorship for 20 more years, but I may be mistaken. Venezuela shows us that, even when you lose half of GDP in 20% of population, you can still run your country as a 20th century style dictatorship.

Markus Brunnermeier: So we have the tradition to end each webinar on a positive note, because you made this very negative prediction. Is there any positive light? If not, I will give you a spin but...

Sergei Guriev: I have something positive to say. I have something positive to say and I'm Russian, I'm not Ukrainian. I'm actually not technically Russian, but that doesn't matter right now. I'm not Ukrainian, but I have lots of friends in Ukraine, and Ukrainians are always offended when people don't talk about the agency of Ukraine itself. For Ukraine, this is what historian Tim Snyder would call bloodlines. There are plenty of countries between Germany and Russia, it's I guess for you, it also resonates and this country's have seen Germany and Russia decide in their future, their faith without talking to them and so Ukraine, like Poland, like Baltic countries

are very worried about this, and this is the time when Ukraine actually shows a lot of agency and you see people fighting. You see the Ukrainian president not running away, even though he was in physical danger, and he still is in physical danger. But you see that the Blitzkrieg, let me use this German word from 1941, did not succeed exactly because Ukrainians work much braver than we thought. And, I think, eventually, if you want an optimistic scenario it's coming not from sanctions or not only from sanctions, we do need three elements. We need the anti war movement in Russia, which is very hard to organize because people are beaten up and arrested. We need some sanctions, but we also need the military victory of Ukraine against their occupation force. And this is something which is not impossible, and if that happens we'll probably go back to a pre-war scenario where Putin will have will keep control over some part of East Ukraine, not clear how big, but maybe bigger than pre war, but the rest of Ukraine will stay independent and indeed may join Europe and your audience voted correctly saying that we should offer a candidate status and start negotiations. As you mentioned, I worked in the EBRD, I know this process very well. These negotiations actually result in structural reforms. A lot of countries carry out structural reforms exactly in order to join and actually roll back some of those reforms after they join. But that will be the credible way to make Ukraine a competitive, open, honest market economy, and so I think there are optimistic scenarios there yeah, but, of course, Russia has many more soldiers, many more tanks so we'll see how it plays out.

Markus Brunnermeier: Thanks a lot Sergei, it was fascinating to hear your perspective and we're hoping that things play out the positive way, ultimately, and the suffering will stop soon. We stay in touch and hope we can exchange views down the road and hope that things play out well thanks.

Sergei Guriev: And thank you very much Marcus. Thank you very much, everybody.

Markus Brunnermeier: And hope to see you again next week, when we talk about investing in a high inflation environment, bye bye.

Sergei Guriev: Thank you.