"Sorry, You're Blocked." Economic Effects of the Financial Sanctions on the Russian Economy

Mikhail Mamonov*† Anna Pestova*‡

September 8, 2021

Abstract

How large are the macroeconomic effects of financial sanctions and how one can distinguish the sanction shocks from other aggregate shocks affecting the economy at the same time? We employ a Bayesian (S)VAR model to estimate the effects of the Western financial sanctions imposed on the Russian economy in 2014 (first wave) and 2017 (second wave). The sanctions decreased the Russia's corporate external debt and raised the country spread, but their effects were confounded by falling oil prices in 2014 (negative terms-of-trade, TOT, shock) and rising oil prices in 2017. We begin disentangling the sanction and TOT effects with a conditional forecasting approach, in which we simulate pseudo out-of-sample projections of domestic macroeconomic variables conditioned (i) solely on the oil price changes and then (ii) on both oil prices and external debt deleveraging. For each endogenous variable, we treat the difference between the two projections as the effect of sanctions. We then apply a structural approach to identify sanction shocks. Our results consistently indicate that the sanction effects were negative and non-negligible across the two sanction waves, being sizeable for the financial variables (real interest rate and corporate external debt) and moderate for the real variables (output, consumption, investment, trade balance, and the ruble real exchange rate). We argue that the estimated effects of sanctions are in line with the theoretical predictions from the literature on country spread shocks in open economies.

Keywords: Financial sanctions, Corporate external debt, Country spread shocks, Terms-of-trade shocks, Bayesian (S)VAR, Sign restrictions, Conditional forecasting, Small open economy.

*MGIMO-University and CERGE-EI. MGIMO-University: 119454 Prospect Vernadskogo 76, Moscow, Russia. CERGE-EI, a joint workplace of Center for Economic Research and Graduate Education, Charles University and the Economics Institute of the Czech Academy of Sciences, Politickych veznu 7, P.O. Box 882, 111 21 Prague 1, Czech Republic.

†E-mail: `mikhail.mamonov@cerge-ei.cz`

‡Corresponding author. E-mail: `anna.pestova@cerge-ei.cz`.

We appreciate valuable comments and suggestions from Zuzana Fungacova, David Hendry, Michele Lenza, Marek Kapicka, Gary Koop, Iikka Korhonen, Dmitry Kulikov, Alexei Netsunajev, Stephanie Schmitt-Grohe, and Ctirad Slavik. We are also grateful to the participants of research seminars at the Center for Macroeconomic Analysis and Short-term Forecasting (CMASF), The Bank of Finland Institute for Economies in Transition (BOFIT) and the Bank of Estonia; participants of the 2016 Rimini Center for Economic Analysis (RCEA) Bayesian Econometrics Workshop, 36th Annual International Symposium on Forecasting (Santander, 2016), the 10th International Conference on Computational and Financial Econometrics (Seville, 2016), 19th INFER Annual Conference (Bordeaux, 2017), and the IOS research seminar at the University of Regensburg for helpful discussions. We thank BOFIT (Helsinki, Finland) and CMASF (Moscow, Russia) for supporting an early version of this research. Any errors are our own. The reported study was funded by MGIMO-University, project number 1921-01-08.