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MINNPOST

As the ruble tumbles, Putin stumbles — and upheaval looms in Russia

By Nick Hayes and Louis D. Johnston | 12/22/14

REUTERS/Maxim Zmeyev

In his annual end-of-the-year news conference, Vladimir Putin placed the blame for the ruble crisis on "outside factors" (read the United States and Western Europe).

The ruble tumbles. The western media gloats in Russia's problems. There's some back-slapping in the Obama White House. Meanwhile, back in Moscow, President Vladimir Putin is putting his spin on the crisis.

On Dec. 17, Prime Minister Dmitry Medvedev (whom President Obama once called "my friend Dmitry" and treated to burgers at Obama's favorite D.C. eatery) gave the leaders of Russian finance, banking and export industries a very public dressing down before the cameras and reporters of Russia's main media.

Medvedev delivered his talking points with a "now, now, gentlemen get a grip on yourselves" tone. First of all, he reminded them and the Russian audience that the ruble crisis stemmed from two factors outside the Russian government's control — the global decline of oil and gas prices and the U.S.-led sanctions which had cut off Russia's access to western capital markets. Secondly, with a perfectly straight face, Medvedev disingenuously stated that Russia had enough foreign currency reserves to stop the freefall of the ruble. Third, and most important, Medvedev put the primary blame for speculation and manipulation of the ruble on a “play on emotions.”

In plain speech, Medvedev’s message is: blame the problem on foreign meddling, including his friend Obama; we still have plenty of money; and shape up.

Really?

Economics of the crisis

Medvedev is technically correct about the proximate causes of the ruble’s fall. Russia is experiencing a financial crisis because declining oil prices combined with Western sanctions are making it difficult for Russian companies to pay their debts. But let’s look more carefully at the connections among oil exports, sanctions, exchange rates and debt so that you can see how this all works.

The key fact to keep in mind is that Russia’s international debt is denominated in dollars (and, to a lesser extent, in euros). This means that the Russian government can’t print rubles to pay off this debt but must accumulate dollars by exporting goods and services and receiving dollars in return. And over the past nine months, Russia has seen the amount of dollars it earns per unit of exports fall dramatically due to sanctions and falling oil prices.

Lower oil prices encourage buyers to purchase a larger quantity of oil, but the demand for oil is such that the 40 percent decline in oil prices will not generate a more-than-40-percent increase in barrels sold. As a result, Russia’s oil revenues are certain to fall and directly reduce the resources available to service foreign debt.

Sanctions imposed by the European Union and the United States in response to Russia’s annexation of Crimea and its support of Ukrainian rebels made things worse by reducing the demand for other Russian exports. This depressed export prices of goods other than oil so that a given quantity of Russian exports earned a smaller amount of dollars than it did before sanctions were imposed. Further, sanctions cut off some exports entirely and eliminated any dollars gained from those sales.

The result: Russia earns fewer dollars that can be used to service its debt.

Now, here comes the financial crisis. Currency traders know about falling export prices, that Russian debt will be harder to service, and that the Russian economy will start to slow down. So they start selling rubles and drive its value down in terms of dollars. This makes it even harder for the Russian government and Russian companies to service their debt because it makes the rubles they earn as domestic (within Russia) income less valuable in dollar terms.

More generally, there is a flight from ruble-denominated assets in Russia itself. That is, stockholders, bondholders and property owners whose assets are denominated in rubles will try to sell these assets in exchange for dollar-denominated assets (or just dollars themselves). This both drives down the value of the ruble further (since the supply of rubles being offered for dollars grows) and decreases the value of stocks, bonds and property

Add this all up and you have a full-blown financial crisis with the ruble plunging in value and investors trying to pull their capital out of Russia.

As if things couldn't get worse, currency traders are betting that the Russian central bank can't prevent the ruble's decline for long because it does not have infinite dollar reserves to stabilize the ruble's value. So currency traders are selling their rubles as fast as they can, forcing the Russian government to use up its reserves of both dollars and, potentially, gold.

The standard solution to this kind of crisis is to ask for a loan from a big country such as the United States, a group of countries such as the EU or an international institution such as the IMF. This solves the problem of the central bank having sufficient reserves to stabilize the currency.

Russia is not going to do this.

Putin's response

Last week, Putin re-enforced Medvedev's theme. In his annual end-of-the-year news conference, Putin placed the blame for the ruble crisis on "outside factors" (read the United States and Western Europe). He also reminded Russians that under his watch Russia's currency reserves had grown to $419 billion as of Dec. 4. When Putin came to power in 1999 in the wake of the 1998 Russian default on its debt, Russia's currency reserves were $13 billion and its obligations included a $133 billion debt. Putin is claiming some bragging rights on the issue of the nation's currency reserves. Finally, Putin called for the nation to brace itself for rough times ahead and to know that the situation will stabilize in a year or two.

What Putin did not do is to hint at a change in the basic direction of his economic and foreign policy. You can infer that a few heads in the Kremlin will probably roll. Putin demands absolute loyalty within his ranks. The demise of an oligarch or two or a few economic ministers would be a warning to any within the Kremlin who might contemplate jumping ship or questioning his overall handling of the economy. Although Putin referred in his remarks to the need to diversify the Russian economy and reduce its dependence on oil and gas exports, watch for him to build on last year's oil and gas agreement with China and expand its role in the Asian markets.

What he will not do is change the direction of his foreign policy. His annexation of the Crimea, interference in the eastern Ukraine, anti-American rhetoric and a cocky swagger in world affairs have boosted his approval ratings in Russia to 80 percent and higher.

What is more, it has gained for him the enthusiastic support of the Russian nationalist right, which previously opposed him and now provides him with a new political base replacing what he has lost among the urban liberals and elites. Take the case of the increasingly popular and right-wing political philosopher Aleksandr Dugin.

Prior to the annexation of the Crimea, Dugin dismissed Putin as a lackey of the West. Now an adviser to the Russian president, he lauds Putin as a national hero who has inaugurated a “Russian spring” that will re-unite the territories lost to Moscow from the Ukraine to the Caucasus and has dared to defy all aspects of Western culture — from its concept of democracy to its support of the gays. Not coincidentally, Dugin calls for Russia’s economic self-sufficiency and its withdrawal from economic inter-dependence with the West.

The Kremlin has started leaking stories to the Western media with an upbeat spin to the crisis. Our favorite is the news that the Sochi Olympic hotel, resort and spa complex is now over-booked with happy tourists who are eager to take advantage of the lower prices.

Perhaps this is the time for you to take that Russian vacation you’ve been promising your family. Or perhaps we would all do better to reflect on the coincidence of the ruble crisis with the third anniversary of the mass protests that rocked the streets of Moscow and take seriously the very real threat of instability and upheaval in Russia’s near future.

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