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INSIGHT

Russia's Invasion of Ukraine: New Financial and Trade Sanctions

February 28, 2022

On February 24, Russia launched a full-scale invasion of Ukraine. On February 26, the leaders of the European Commission (the European Union's main executive body), France, Germany, Italy, the United Kingdom, Canada, and the United States announced that specific Russian banks will be removed from the SWIFT (Society of Worldwide Interbank Financial Telecommunication) financial messaging system, as well as measures to prevent the Russian central bank from accessing a portion of its international reserves. Between February 22 and February 25, the United States and allies also expanded sanctions on Russian sovereign debt, Russia's two largest banks (Sberbank and VTB, which account for about 50% of banking assets in Russia), and technology exports to Russia, among other targets.

For more on U.S. and allied responses to Russia's invasion, see CRS Insight IN11869, *Russia's Invasion of Ukraine: Overview of U.S. and Allied Responses*, and CRS Insight IN11866, *Russia's Invasion of Ukraine: NATO Response*.

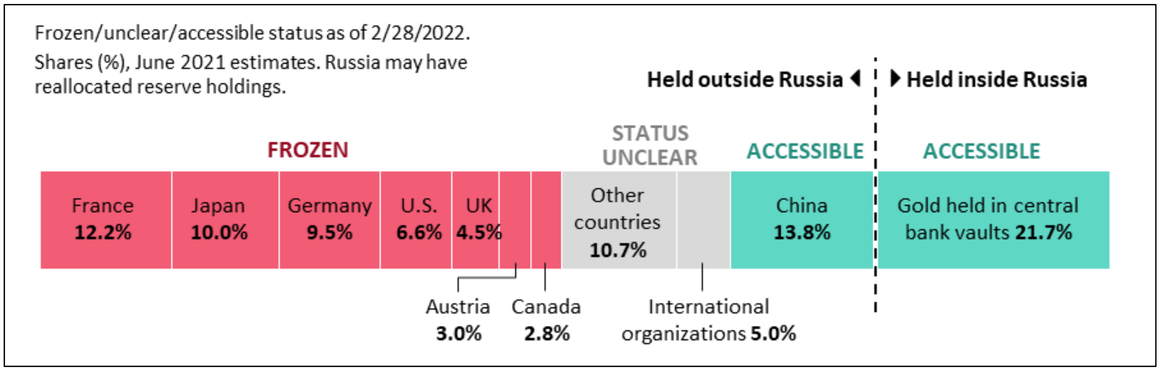
SWIFT Sanctions

Globally, financial institutions use financial messages to send payment instructions to other banks in order to process financial transactions, such as which accounts to debit or credit. The main international financial messaging system used around the world is SWIFT. SWIFT is headquartered in Belgium and owned by over 2,400 financial institutions. More than 11,000 financial institutions from 200 countries use SWIFT's messaging services for cross-border payments. Removing key Russian financial institutions from SWIFT makes it difficult for them to process cross-border payments. SWIFT sanctions, although used with Iran, are generally rare. U.S. and European policymakers have discussed removing Russia from SWIFT since Russia's first invasion of Ukraine in 2014, although policymakers had been reluctant to do so given potential economic disruptions. Reportedly, the purpose of excluding some but not all Russian banks from SWIFT is in part to allow for continued payments for European imports of Russian natural gas.

Central Bank Sanctions

The Bank of Russia has large reserve holdings, totaling $630 billion at end-January 2022. Russia, like many central banks, holds a portion of their reserves abroad, in other central banks and commercial banks. The G-7 countries announced that they are blocking Russia's access to its reserve holdings in G-7 jurisdictions. Based on the most recent data available (from June 2021), this means about half of Russia's reserves may be frozen (**Figure 1**). This number could be higher or lower, especially if Russia reallocated its reserves during wartime planning. Assuming these sanctions freeze a significant portion, Russia would have fewer resources to fund its war effort and support its economy. Freezing reserve assets is unusual but with precedent. The United States placed a hold on Afghanistan's reserves at the Federal Reserve Bank of New York in August 2021, following the Taliban takeover, and the Bank of England blocked Nicolás Maduro from accessing its holdings of Venezuelan gold.

Figure 1. Bank of Russia Reserves: Estimating the Portion Frozen



Source: Bank of Russia data for June 2021 (latest available).

Notes: Russia may have reallocated its reserve holdings between June 2021 and February 2022. These figures should be viewed as estimates.

Sovereign Debt and Banking Sector Sanctions

The Biden Administration also expanded sanctions on Russian sovereign debt and several Russian financial institutions. The new sanctions restrict U.S. purchases of Russian bonds and the ability of Russia's largest bank (Sberbank) to transact in U.S. dollars. The new sanctions prohibit all U.S. transactions with and block any U.S.-based assets of Russia's second largest bank (VTB) and three other systemically important financial institutions in Russia, as well as two Russian state investment funds (VEB and RDIF, Russia's sovereign wealth fund). These sanctions have exemptions, including for energy transactions, but (combined with other international sanctions on Russia) generally restrict Russia's ability to borrow from Western capital markets and process transactions in U.S. dollars.

Export Controls

Categories of Technology Subject to New Controls

- Electronics
- Computers
- Telecommunications and Information Security
- Sensors and Lasers
- Navigation and Avionics
- Marine
- Aerospace and Propulsion

On February 24, the U.S. Department of Commerce's Bureau of Industry and Security (BIS) filed a notice of a new rule that restricts the transfer of certain technologies to Russia. In addition to imposing new restrictions on the export of certain U.S. technologies to Russia, the new rule restricts the export of goods produced in foreign countries using controlled U.S. technology. More than thirty countries already have, or have announced they are implementing, similar controls. The new controls target technologies critical to Russia's defense industrial base and intelligence services. Russia could source certain technologies from China, although not for Russian crucial military needs. While the new controls are expansive, they are not comprehensive. For example, the controls exempt certain consumer electronics, such as smart phones.

Economic Implications

The sanctions include exemptions for energy transactions. Some details remain to be specified (such as which Russian financial institutions will be removed from SWIFT), and additional sanctions could be imposed (including secondary sanctions and additional trade measures). Regardless, the economic effects of rapid, significant, and coordinated multilateral sanctions, in addition to the war, are expected to be significant.

In Russia, the sanctions will likely trigger a run on Russian banks, capital flight, depreciation of the ruble, and inflation, even though Russia has tried for years to insulate its economy from sanctions. On February 24 (before the SWIFT and central bank sanctions), the MOEX, the benchmark Russian stock market index, was almost 30% down on February 24 from its October peak and the Moscow stock exchange suspended trading.

Western economies are also likely to be affected. Although the direct exposure of Western banks to Russia is relatively low, some particular banks are more exposed, including Raiffeisen (Austria), UniCredit (Italy), Société Générale (France), and Citi (United States).

Globally, many transactions will likely be disrupted. Russia is a major energy exporter; Russia and Ukraine account for a third of global wheat exports; Russia is a major supplier of several metals, including titanium (used in airplanes), aluminum (used in cars, among many applications), and nickel (used in batteries); Russia and Ukraine are key sources of chemical gases used in semiconductor production; and several western law and consulting firms have offices in Russia and Ukraine, among others. Disruptions in supply chains and energy markets could accelerate inflation in the West and complicate the U.S. Federal Reserve's decisions about raising interest rates.

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