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How U.S. Default Would Hit Russia

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By [Howard Amos](#)



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Construction workers walking on the Garden Ring. The banner above them reads, "The future is beautiful."

There probably aren't many things that Sberbank president and former economy minister German Gref tries not to think about. But a U.S. default, which will take place if warring political parties in Washington cannot agree on a deficit reduction plan, is one of them.

"I don't even let that thought cross my mind. If it happens, it will have, to put it mildly, catastrophic consequences for the world's financial system," Gref said at a news conference Friday.

Republicans and Democrats are currently locked in negotiations ahead of an Aug. 2 deadline for raising the U.S. debt ceiling from its current level of \$14.3 trillion. President Barack Obama warned last week that a default was not an "abstract" issue, while ratings agencies Moody's and Standard & Poor's have threatened to downgrade the United States' coveted "triple-A" rating.

Those predicting a global financial cataclysm and economic meltdown as a result of a U.S. default have no difficulty

in foreseeing how events would take their course in Russia.

"It would make 2008 look like a walk in the park," said a senior Western banker in Moscow, referring to the global recession sparked by bad U.S. housing debt and the collapse of Lehman Brothers.

"Global GDP would plunge, meaning global demand for commodities becomes nonexistent," said the banker, speaking on condition of anonymity to talk candidly about a speculative event. "There would be nobody to buy the oil, the gas, the steel. ... Essentially, Russia's economy would be wiped out."

Jochen Wermuth, founder and chief investment officer of Wermuth Asset Management, which has overseen more than \$1 billion in Russian equity investments, was more cautious but no less apocalyptic.

"I don't believe anybody knows what will happen — most likely the whole world will lie in ruins for decades," he said.

Other experts, however, said the consequences of a U.S. default would be similar to the effect that U.S. economic problems had on the international economy in 2008. Russia saw a crisis with significant capital outflows, a sharp drop in the oil price and a 9 percent contraction of GDP.

"For Russia it would look very similar to 2008, which means that the uncertainty would hit all businesses orientated toward exports," said Natalya Orlova, chief economist at Alfa Bank.

She said it would provide temporary relief to some manufacturers for the domestic market but prove "very negative" for people's purchasing power because it would likely cause the ruble to weaken.

Russia's exposure to the dollar is significant. The Central Bank holds \$250 billion to \$300 billion — about half of its foreign currency reserves — in dollars, said Sergei Guriev, president of the New Economic School.

He said Russia is currently more vulnerable to a global financial shock than it was in 2008, particularly because of a depleted reserve fund and greater budgetary dependence on oil. Before the crisis, Russia's budget was balanced at \$50 to \$60 a barrel, while now the figure, by some estimates, is closer to \$120. About 40 percent of the government's revenue comes from the oil and gas industry.

"If there is a similar crisis, then Russia will really be in trouble," Guriev said. It "will have to cut expenditures, which will be very painful because it will have to cut a lot."

A significant contraction in the budget would pose difficult decisions on what to cut for a newly elected State Duma in December and the winner of the presidential election in March 2012.

But some analysts contacted by The Moscow Times saw a glimmer of hope for Russia in the case of a U.S. default.

"You could argue that Russia is in a really good position: Its debt is low, it doesn't have huge borrowing requirements, and its current account is in a good position," said Charles Robertson, chief economist with Renaissance Capital.

"There is a fairly good chance that Russia would be surprisingly stable in a U.S. default story," he said.

He added, however, that there was a good chance that all emerging markets would suffer in the event of a U.S. default.

But few people actually think a default will occur, putting talk about the subject down to a game of brinkmanship

in Washington.

"It would be total armageddon. That's why it's not going to happen," said the senior Moscow banker who requested anonymity.

Robert Maciejko, a partner at consulting company Oliver Wyman, said the outcome of the U.S. negotiations might even be a welcome one.

"If it's a big unexpected negative shock, it could have a serious impact internationally," he said. "But if things close relatively quickly and positively, the opposite could happen and we might have a relief rally."

But Chris Weafer, a banker who lived in Russia during the 1998 default and the 2008 recession, predicted that the U.S. Congress is likely to reach a compromise before the deadline and uncertainty in the markets will continue for the next six to nine months.

Weafer, chief strategist and head of research for ING Bank in Russia, said that until upcoming election cycles in the United States and Europe end, the best investors can expect is an "oscillation between hope and debt threats."

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