

A DISCUSSION OF
“SANCTIONS AND THE EXCHANGE RATE IN TIME”
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The views are those of the discussant and not of the represented institution

What of the proposed sanctions on Russia? Consider the limitation on exports of grain. (...) Many countries, in the Soviet bloc and outside it, will not join the embargo. And those countries that do join the embargo will not be able to enforce it effectively (...)

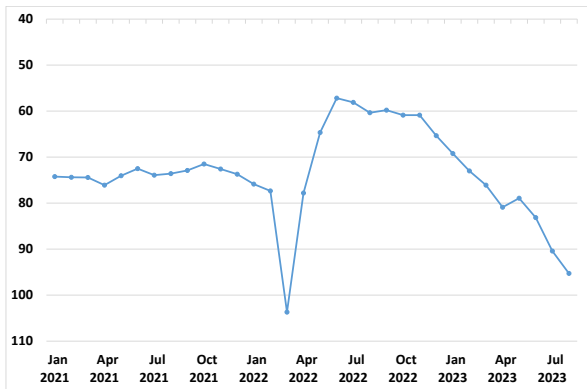
High-technology products are less fungible than wheat, so in principle it should be easier to enforce an embargo on them. However, the difference is likely to be minor. Items shipped to one country can readily be reshipped elsewhere. In addition, we are not the only country producing such products. (...)

All in all, economic sanctions are not an effective weapon of political warfare. (...) The resort to economic sanctions is a confession of impotence, crafted primarily for domestic consumption, to reassure the public. **It will have little or no influence on the Russians.**

"Economic Sanctions", by Milton Friedman, Newsweek, 21st January 1980, p. 76

- The strong rebound of the Russian rouble after the sharp depreciation immediately after the Russian invasion of Ukraine has been interpreted as a sign of ineffectiveness of the sanctions currently targeting Russia
- Eichengreen et al. [2023](#) explain why this is not the case

Figure - Russian roubles per USD (inverted scale)



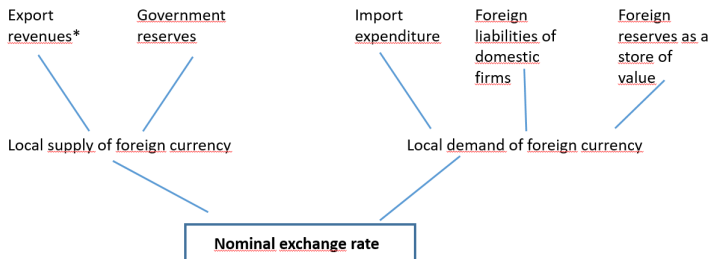
Source: IMF International Financial Statistics. Notes: Monthly averages.

1 MAIN CONTRIBUTIONS OF THE PAPER

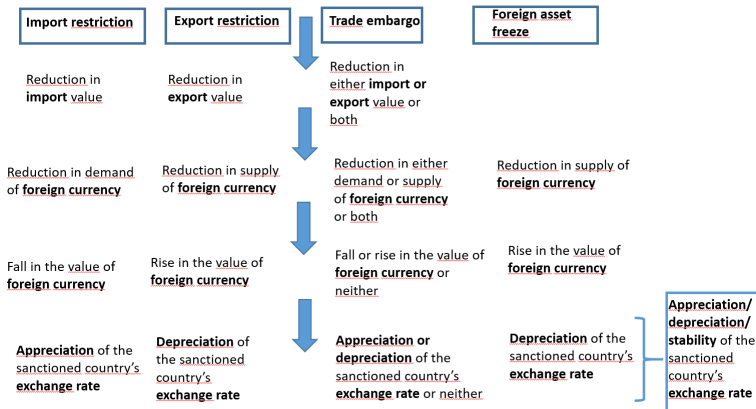
2 ADDITIONAL HETEROGENEITY IN THE SANCTION-EXCHANGE RATE LINK

3 REAL IMPACT OF SANCTIONS VIA THE EXCHANGE RATE

- By using a novel dataset on economic sanctions and exchange rates over 1914-1945, the paper tests the predictions of two recent theoretical studies (Itskhoki and Mukhin 2022; Lorenzoni and Werning 2022) modelling the **sanction-exchange rate link**



*providing dominant or local currency pricing hold



- The paper estimates the dynamic response of the exchange rate to different types of sanctions using local projections, controlling for country and time fixed effects and covariates, and explores the **transmission mechanisms** (imports, exports and assets frozen)
- The effects of sanctions on the exchange rate are found to depend on the **sanction type**, consistently with theory (also with Ghironi et al. 2023)

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- **Partial vs. complete, unilateral vs. multilateral sanctions**

The impact of sanctions on trade varies according to their degree of completeness (Felbermayr et al. 2020) and if they are applied by an individual country or by a group of countries (Syropoulos et al. 2023)

Figure A - Partial vs. complete trade sanctions in 1950-2015

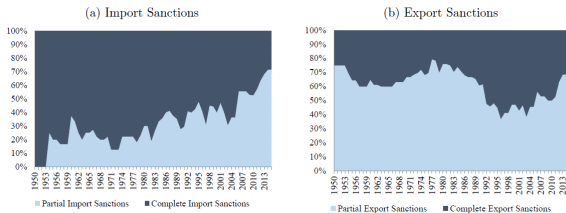
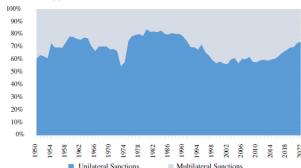


Figure B - Unilateral vs. multilateral sanctions in 1950-2022



Sources: Felbermayr et al. 2020 and Syropoulos et al. 2023.

- **Surprise vs anticipated sanctions**

Sanctions may be priced in before their official introduction owing to market speculation, informal announcements or leaks

E.g. Tweets by the U.S. President regarding possible tariff increases on Canadian and Mexican goods appreciated the US dollar (Matveev and Ruge-Murcia [2021](#))

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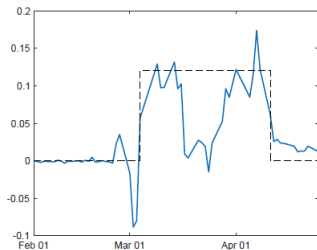
- **Permanent vs. temporary sanctions**

The net effect of e.g. import restrictions on the exchange rate depends on the inter-temporal elasticity of substitution (Itskhoki and Mukhin [2022](#))

- **Multiple foreign currencies**

Under differential financial repression measures across currencies, the domestic-market exchange rates of these currencies could be different to their global exchange rate

Figure - Swiss franc vs U.S. dollar exchange rate at the Moscow Exchange in 2022

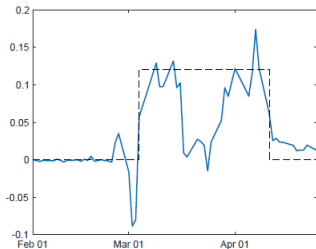


Source: Itskhoki and Mukhin [2022](#). Notes: The exchange rate refers to the Moscow Exchange w.r.t its international value in selected months of 2021. Russia's tax on purchasing US dollars is plotted as a dashed line. The values on February 1st 2021 are normalized to 0.

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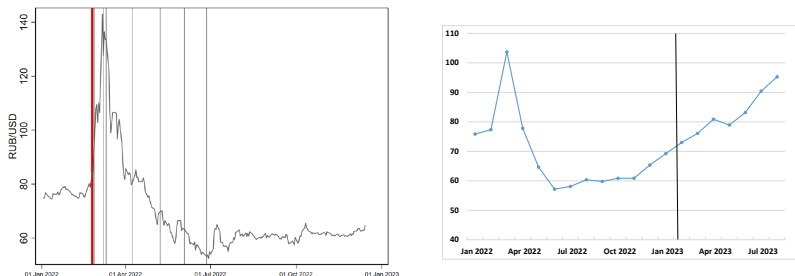
- **The rise of black markets**

When, in addition to trade restrictions and asset freezes, capital controls are introduced, black markets for foreign currency may arise (Lorenzoni and Werning [2022](#))

● Timing of the impact

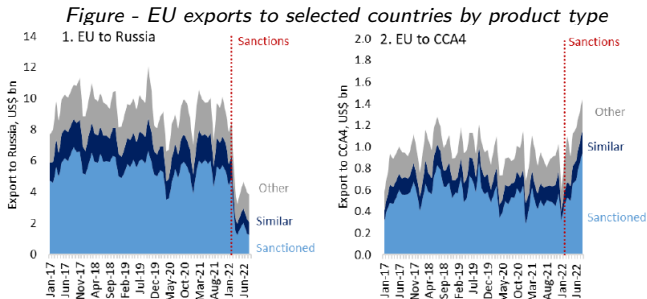
How long does it take for the sanctions to affect the exchange rate? Are there differences across sanction types? Are grandfathering rules significant in delaying the impact?

Figure - The RUB/USD exchange rate after Russia's invasion of Ukraine



Source: Eichengreen et al. 2023 and IMF, International Financial Statistics (monthly averages). Notes: A rise (fall) in the exchange rates points to a depreciation (an appreciation) of the rouble. Russia's invasion of Ukraine on 24 February 2022 is shown as a thick red line and selected packages of sanctions as thin black lines in the left-hand chart.

- The relative **strength of the import/export transmission channels** of sanctions to the exchange rate may be affected by:
 - ▶ **Circumvention of sanctions** (e.g. the Eurasian roundabout and re-routing via Türkiye and Serbia; Chupilkin et al. [2023](#) and Borin et al. [2023](#))
 - ▶ **Export deflection** (e.g. rise of Iranian exports to non-sanctioning countries; Haidar [2017](#))



Source: Chupilkin et al. [2023](#). Notes: Based on trade reported by exporters. Trade in nominal US dollars is adjusted for US inflation. CCA4 include Armenia, Georgia, Kazakhstan and Kyrgyzstan.

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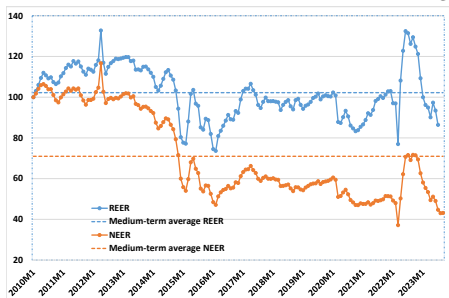
3 REAL IMPACT OF SANCTIONS VIA THE EXCHANGE RATE

THE REAL EFFECTS OF SANCTIONS

Sanctions can affect economic growth of the targeted economy

- **directly**, e.g. by restricting goods variety for consumers (Broda and Weinstein 2004; Gutmann et al. 2021) or by limiting key inputs and assets for production (Borin et al. 2022) or by reducing a country's ability to sell goods and assets to the rest of the world (Felbermayr et al. 2020; Demertzis et al. 2022)
- and **indirectly**, e.g. via real exchange rate movements

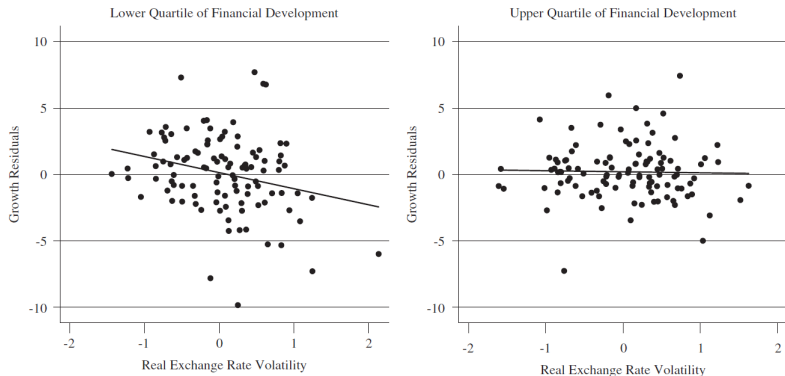
Figure - Russia's real and nominal effective exchange rates



Source: Bank of Italy. Notes: Index 2021M1=100. A rise (fall) in the exchange rates points to an appreciation (a depreciation).

- Sanctions can spur **exchange rate volatility**, which in turn hinders exports and productivity growth, when **credit constraints** are present (Aghion et al. 2009; Héricourt and Poncet 2015)

Figure - Exchange rate volatility and productivity growth



Source: Aghion et al. 2009. Notes: The growth residuals are derived from a pooled growth regression using five-year average data for 83 countries over 1970–2000. Exchange rate volatility is measured as the standard deviation of annual log differences in the real effective exchange rate.

- Sanctions can lead to **real exchange rate misalignments** relative to long-run economic fundamentals, in turn hampering the **efficient allocation of production factors** across tradable and non-tradable sectors and thus lowering economic growth (Giordano [2023](#))
 - ▶ Overvaluations can block the relocation of surplus labour and capital from low-productivity to high-productivity activities (Razin and Collins [1999](#); Edwards [2000](#); Rodrik [2008](#))
 - ▶ Undervaluations can result in more expensive imported goods, curbing investment and leading to an expected currency appreciation, which in turn could limit the size of the more productive tradable sectors (Jongwanich [2009](#); Schröder [2013](#))

- This is a very original empirical contribution to the **literature on sanctions and exchange rates** through the lens of economic history
- The exchange rate does not signal the degree of **effectiveness of sanctions** as it is the outcome of offsetting forces
- Looking forward, the manifold **heterogeneous dimensions of sanctions** and the relative strength of the various transmission mechanisms will drive the Russian rouble exchange rate
- Economic history can also contribute to understanding the **long-run real effects of sanctions** on the targeted country, e.g. via the exchange rate volatility and misalignment channels

Thank you for your attention