

## Why Russia should fear appreciation of the ruble against the dollar

The appreciation of the ruble has resulted in a loss of oil revenues of around 27 percent, apart from the discounts that have to be offered to Chinese and Indian buyers

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An ominous headline from [Reuters](#) on June 30, 2022, announced, 'Russian ruble rallies; Gazprom shares plummet after it skips dividend'. Contrary to what may seem obvious, it is the appreciation, not the depreciation, of the ruble that Russia is and must be wary of.

The ruble, if it were to continue on its present [path](#) of being the 'best performing currency' in 2022, may actually trigger a major economic crisis. [This](#) is becoming increasingly clear with action by the Central Bank of Russia to relax strict capital controls as well as norms requiring payment by 'unfriendly' countries to pay for its oil and gas in rubles. The problem, however, is for Russia to influence the US dollar (\$)–ruble (RUB) rate through interventions in foreign exchange markets. The US sanctions imposed on Russia in late February 2022 prevents transactions by/with the Central Bank of Russia to purchase/sell dollars to control the ruble-dollar rate. At the same time, international oil prices being outside its direct control, makes Russia increasingly vulnerable to ruble-dollar appreciation.

Consider the situation with oil prices at about US dollars (\$) 108/barrel and the RUB/\$ rate at 51.50. This means that Russian oil companies receive RUB 5562/barrel of oil. If the rupee (INR)/\$ rate is close to 79, then given that the maximum price that Indian importers will pay for Russian oil is RUB 5562, the maximum INR/RUB rate must be about INR 1.53/RUB. Any appreciation of the ruble above this will make oil cheaper for Indian buyers from international sources. Of course, oil is not the only commodity that Russia trades in – coal and other commodities could play some part in the rupee-ruble rate.

There is a further problem for Russian producers. If the rupee-ruble rate were INR 1.53/RUB, there is no real advantage for Indian buyers to procure Russian oil. It is therefore imperative that Russian

producers offer an attractive discount on their oil so that Indian buyers will be willing to defy US sanctions to buy Russian oil. Reports say Russian oil producers are offering cheaper prices to attract Chinese and Indian buyers. In fact, the present rupee-ruble rate of 1.40 itself implies that Indian buyers are paying almost 10% less for Russian oil as compared to the international price. Further price discounts may be necessary – and there are [reports](#) that 30% discounts are actually being given – to induce buyers from India and China to source Russian oil. It is, therefore, obvious why Gazprom had to skip dividends with the rising ruble.

If the ruble were to appreciate against the dollar to, say, RUB 50, with no change in international oil prices, the amount received by the Russian producers will decline to a maximum of RUB 5400. Everything else constant, the rupee-ruble rate must also adjust to a maximum of INR 1.58/RUB. An appreciation of the ruble above this level will induce Indian buyers to switch to other international oil suppliers. The bottom line is that Russia's Gazprom cannot get more than RUB 5400 if the ruble appreciates to RUB 50/\$.

It is interesting to note that the dollar-ruble and rupee-ruble rates have moved closely in tandem. Both currencies appreciated vis-à-vis the ruble by close to 75% between February 17 and March 7, 2022, and then depreciated by 60% since then.

If the RUB/\$ exchange rate were at the pre-sanction rate of about RUB 71/\$, with the price of oil at \$108/barrel, Gazprom would have been receiving a revenue of RUB 7668/barrel. The appreciation of the ruble has therefore resulted in a loss of revenues of around 27% apart from the discounts that have to be offered to Chinese and Indian buyers. Meanwhile, with real wages rising in Russia - nominal wages increasing in excess of the already high inflation rates – would have put further pressure on Gazprom's profitability, especially as net receipts have actually fallen in spite of strong crude prices.

Other oil exporters do not face this predicament. For instance, the Saudi riyal (SAR)/\$ rate pegged to the dollar at approximately 3.75 gives Saudi Arabia a steady revenue of SAR 375 per barrel from oil exports. Of course, the possibility for Saudi Arabia's central bank, SAMA, to intervene in preventing the riyal to appreciate is crucial for it to maintain its oil revenues.

The other fears that Russia has to contend with are falling oil and commodity prices that could arise if the US economy were to descend into a recession on account of the interest rate hikes deployed by the Fed. The possibility of both occurring, namely an appreciation of the ruble with falling oil prices could spell disaster for the Russian economy. However, oil prices since March 2022 have remained firm at about \$ 108/barrel, with highs of about \$ 120 and lows of about \$ 95/barrel. The only silver lining for Russia in the present situation would be if oil prices rise further in the near term.

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***Views are personal and do not represent the stand of this publication.***