

## **Sanctions against the Russian Federation and their possible consequences for Kazakhstan.**

Analysis is done by the FIST Credit Bureau as of March, 15, 2022

There are currently 5 main scenarios for development of the situation in Ukraine. Three of them involve military actions: either a quick victorious war by Russia (this scenario can already be considered unrealistic), or a long war in Ukraine, or large-scale military operations, including in Europe (which is unlikely, we hope). While neither of these has a direct effect on Kazakhstan, the latter scenario is the worst. In this case Kazakhstan would have to choose between its largest trade partner, Russia, and European buyers of raw materials and international investors, without which its economy would collapse. It is unlikely to be able to sit on two chairs in such circumstances, even with complete neutrality. The fourth option is a diplomatic solution to the conflict. The parties, not wanting further casualties, come to some kind of compromise, smoothing out the acute phase. The fifth option is unlikely, but it cannot be excluded. Big business is losing faith in the current government in Russia, the Russian population is suffering from the sanctions, and the military operation is becoming increasingly bloody - under such a scenario, the overthrow of the regime in Moscow cannot be excluded. There is also the sixth scenario. We would like to believe that it is impossible. Nuclear war. The consequences are clear so we will not consider it.

### **Scenarios for development of the events**

**Scenario #1. Quick war**

<b>Essence</b>	<b>Probability and consequences</b>
<p>Russia is engaging in more and more active military actions. More random artillery and missile strikes are being launched against Ukraine. Russian aviation, which has played a minor role till now, is launching crushing air strikes.</p> <p>Massive cyber-attacks have swept across Ukraine, targeting key national infrastructure. Power supplies and communication networks have been cut off. Thousands of the civilians are being killed.</p> <p>Kiev falls, the pro-Moscow regime takes over. Russia declares victory and withdraws some forces, leaving enough to maintain some control. Thousands of the refugees continue to flee to the west. Ukraine joins Belarus as a client state of Moscow.</p>	<p>This outcome is possible but will depend on several factors: more effective actions by the Russian troops, the deployment of more forces and extinction of fighting spirit in Ukraine.</p> <p>Russia can attain a regime change in Kiev and an end to western integration of Ukraine. But any pro-Russian government would be illegitimate and vulnerable for the rebels. Such an outcome would remain unstable and the likelihood of repeated conflict would be high.</p> <p>For Kazakhstan, such a scenario carries no direct risks: the situation would resemble the Donbass of recent years, remaining an active local conflict, although on a much larger scale.</p> <p>As of 15 March, this scenario can be considered irrelevant - the fighting has been going on for almost 3 weeks.</p>

Scenario #2. Long war

Essence	Probability and consequences
<p>The blitzkrieg fails, Ukraine receives support from the West and volunteers from all over the world come to fight on its side. The Russian forces bog down, morale is undermined and logistics begins to suffer. The battles for the cities become fiercer, longer and more exhausting for both parties.</p> <p>The Ukrainian Defence forces are being transformed into rebel movement well motivated and supported by the local population.</p>	<p>The fighting resembles the Chechen war and Afghanistan, is resource-intensive and places a heavy burden on the economies of both countries.</p> <p>After a few years, Russia declares the mission accomplished, but keeps the peacekeeping forces, which allows it to focus on solving the problems that have accumulated. Ukraine (probably with a new regime) rebuilds its economy under the supervision of the international organizations. A kind of the Middle East or divided Germany scenario.</p> <p>Such a scenario poses no direct threat to Kazakhstan. All risks are related either to sanctions (including secondary ones) or to deterioration of the economy of its most important trading partner. But in a prolonged conflict, Kazakhstan may reorient itself towards other markets, including with its exit from the EEU. Russia could try to draw Kazakhstan and other CSTO countries into the conflict by ultimatum, which could, at the very least, spoil the relations between the RK and the RF.</p>

**Scenario #3. Continental war**

Essence	Probability and consequences
<p>The war extends beyond Ukraine. The issue of Transdnistria, Abkhazia and other territories comes up again. The Russian troops are being sent to Moldova and Georgia, which are not part of the NATO.</p> <p>Russia may declare supplies of the Western weapons to the Ukrainian forces an act of aggression requiring retaliation. This is followed by the threats to send the troops to the Baltic states, such as Lithuania, to establish a land bridge with Kaliningrad. In this case, a strike would be launched against the NATO territory, but such a scenario is unlikely.</p> <p>Inclusion of the countries around the world into the fight against the “Russian threat: aggravates social, political and economic problems within the macro-regions, which the opposition forces are trying to exploit. A new round of development of the Islamic radicalism that is gaining momentum; emergence of powerful local ideological and religious forces (such as the Irish Republican Army, the Catalan associations, the Kosovo armies, etc.)</p>	<p>This is extremely dangerous and has the potential for war with the NATO. According to Article 5 of the military alliance charter, an attack on one member is an attack on all. But it is possible that a failed operation in Ukraine could lead to a breach of the world standards for the sake of maintaining power by the current Russian regime.</p> <p>The same logic can be applied to use of the nuclear weapons. Russia has put its nuclear forces on high alert. It hardly means that their use is probable or inevitable. But it was a reminder that the Russian doctrine allows the possible use of tactical nuclear weapons on the battlefield.</p> <p>For Kazakhstan, such a scenario is extremely negative. On the one hand, it is a key trading partner, providing a third of trade, and a long-standing ally. On the other hand, - the European buyers of raw materials and global investors, without whom Kazakhstan's economy would collapse.</p> <p>Should the hostilities shift to Russia, Russia could request military assistance from the CSTO, and Kazakhstan would be drawn into the conflict as a participant</p>

Scenario #4. The Diplomatic way out

Essence	Probability and consequences
<p>The parties are taking the first steps to resolve the conflict. Several rounds of the negotiations have been held between Russia and Ukraine. There is no tangible progress so far, but it is possible that Russia has accepted the possibility of negotiating cessation of fire.</p> <p>The negotiations are continued between the leaders of these countries and the presidents of the world states (e.g. France). Meanwhile, talk of Ukraine joining NATO (one of the main stated reasons for the Russian attack) is gradually subsiding.</p> <p>It is possible that in the end Ukraine will receive assistance from the states of the world, but will not join the block. Russia, for its part, will remain under sanctions, but it is stated that they are temporary and can be eliminated if certain conditions are met</p>	<p>Why no? Let's imagine such scenario: the war is not going as planned for Russia, the sanctions are starting to get in the way, and opposition is growing. The authorities believe that continuing the war could be more threatening to them than the reputational costs of ending it. China intervenes, forcing Moscow to compromise, warning that it will not buy Russian oil and gas if Russia does not de-escalate. Meanwhile, the Ukrainian authorities see the ongoing destruction of their country and conclude that political compromise may be better than this.</p> <p>Ukraine recognises Russian sovereignty over Crimea and parts of the Donbass. In turn, Russia recognises Ukraine's independence.</p> <p>Such a scenario has no direct effect on Kazakhstan. But the sooner the parties decide, the more certainty will appear, and the easier it will be to restructure the economy in view of new realities.</p>

**Scenario #5. Regime change in Russia**

Essence	Probability and consequences
<p>This option was not considered until a few weeks ago. However, political analysts are increasingly saying that regime change in Moscow is almost as likely as in Kiev.</p> <p>Why? Thousands of the Russian soldiers are dying. The well-honed state propaganda fails to convince everyone that the Russian army has nothing to do with the deaths of the civilians and destruction of infrastructure in Ukraine. Economic sanctions are biting. The rouble is falling down. The outflow of the foreign companies leads to a shortage of the consumer goods. The mood of the population is changing - patriotism alone is no longer an option and the president is losing support.</p> <p>The population goes to the rallies which are suppressed by use of the power-based methods. This used to cause resentment before but may now escalate into something more. Affected businesses (including those with political ambitions), criminals and radical forces join the protesters.</p>	<p>Now this may seem unlikely. But it is not impossible if the people who have benefited from the Putin's years in office no longer believe that he can protect their interests. Especially if he does not act to lift the sanctions on the Russian oligarchs' business. Or not enough support is given to the latter.</p> <p>For Kazakhstan, the scenario is rather neutral. There have been many years regimes changes in Uzbekistan and Turkmenistan. In Kyrgyzstan, the presidents change regularly. A new elite is on the way in the RK, who may find it easier to deal with the new Russian regime than with the current one.</p>

## **Sanctions and their consequences**

No sanctions were directly aimed at Kazakhstan or Kazakh businesses. However, given Russia's role as a trading partner, even indirect impacts can be very strong. Below are some of the most significant restrictions that Russia has faced in recent weeks.

It is important to note that the restrictions come in several varieties:

- Sanctions - a ban initiated by the head of the country or an international financial organization. It means that on the government's side, therefore it is often more politicized in nature. Typically, sanctions are quickly imposed but take a long time to be lifted.
- A boycott is a ban on all or part of the activities of the companies, i.e. private capital. If the situation improves, it will be lifted first, provided that the market is still interesting for business.
- Decision by the authorities - measures taken by a country on which sanctions have been imposed. More often they are taken in the form of counter-sanctions: for example, banning the export of certain products to the same countries. Theoretically, they can be lifted at any time, but they are often bogged down as they become subject to political bargaining.

The tables present the main sanctions already imposed with the scenarios of impact on Kazakhstan (as is, bad, worst). The main possible social consequences for Kazakhstan are also presented.

## Financial Sanctions

Form	Sanction	As is	Bad	Worst
Sanction	Switching some banks from SWIFT	Potential problems with international settlements with the Russian issuers. Looking for alternative ways, including through the "buffers".	Sanctions affect the subsidiaries of the Russian banks, which strikes a blow against Kazakhstan's financial system.	Kazakhstan is also affected by shutdown, bringing all international trade to a standstill
Sanction	Freezing of the Russia Central Bank reserves	Security of the currency has fallen, which is one of the reasons for the fall in the exchange rate.	Weak <u>rouble</u> leads to the capital outflows from Kazakhstan to Russia, dumping, etc.	Imposition of the collective sanctions on EAEU/CSTO countries, so that Kazakhstan loses significant opportunities to support its national currency and economy as a whole
Boycott	Withdrawal of the financial institutions (MasterCard, Visa, Goldman Sachs, etc.)	Chinese financial institutions, like <u>UnionPay</u> , come to take their place.	Exit of the players from Kazakhstan, for whom Kazakhstan was just a supplement to the Russian market and not interesting to them.	Financial international isolation. Only players from Kazakhstan and neighboring countries (which did not join the sanctions), which are limited by their own technologies, stay in the market.
Sanction	Ban on the transactions in securities of the sanctioned Russian issuers and the Russian government.	Investment opportunities for the companies are reduced. Including those companies whose economic activities are in some way or another connected with Kazakhstan	Production capacity of certain companies will be reduced, and the projects (where Kazakhstan capital could be involved or has been already present) will be frozen.	Imposition of the collective sanctions on EAEU/CSTO countries, so that Kazakhstan loses significant opportunities to support its national currency and economy as a whole
Decision of the Russian authorities	Restriction of free currency conversion	Russian population goes to Kazakhstan for currency, increasing demand for it, and thus putting pressure on the exchange rate. Kazakhstan has imposed the restrictions of export of currency and precious metals.	A gray currency market appears in Russia and Kazakhstan, where the exchange rate differs significantly from the official one. This complicates work with Russia significantly.	Too much external pressure forces the National Bank to limit the volume of currency transactions for people in Kazakhstan as well. This also applies to business, which is forced to sell a part of their foreign currency earnings at the domestic market.



## Logistic Sanctions

Form	Sanction	As is	Bad	Worst
Sanction/Boycott	Ban on the transactions with the Russian oil products	It does not affect Kazakhstan on paper: transit is continued by the old routes through the Russian territory.	Oil transit is significantly complicated by bureaucracy and reluctance of the traders to deal with the raw materials linked to Russia in one way or another.	Oil transit through Russia becomes impossible and there are practically no alternatives.
Sanction	Ban on goods exports to Russia	Disruption of the transit supplies to Kazakhstan	Transit to Kazakhstan discontinued through the traditional routes.	Ban on transit to Kazakhstan by traditional routes.
Sanction	Ban on goods imports from Russia	Domestic market focus and saturation of the markets where we have access	Reduction of transit through Kazakhstan.	Complete cessation of the supplies to Kazakhstan and transit through Kazakhstan.
Sanctions/Boycott/ Decision of the Russian authorities	Ban on air travel	Closure of the Russian sky to almost the whole world. Increased importance of the Kazakhstan sky, increased income from transit. Reduction of flight connection between Russia and Kazakhstan due to the problems with insurance coverage.	Flight connection between Russia and Kazakhstan shuts down due to insurance coverage problems and aircraft fleet degradation.	Kazakhstan sky also becomes closed, with the airlines restricted in their access to the European sky.
Sanctions/Boycott	Port access bans/refusal of the logistic companies to work	Potential increase in demand for transit through Kazakhstan	Alternative supply chains include the Baltic, Scandinavian countries, China, etc. Kazakhstan revenues do not change much.	Refusal from transit through Kazakhstan

## Trade Sanctions

Form	Sanction	As is	Bad	Worst
Boycott	Embargo on the commodities transactions	Companies are refusing from the transactions with the Russian oil. On the one hand, it is to their detriment, but on the other hand, the price of Urals is falling.	JVs of the Kazakh and Russian commodity companies, Russian companies in Kazakhstan and Kazakh companies in Russia have problems with the sales	Boycott extends to the EAEU countries
Sanction	Ban on a number of imports (mainly, high-tech industrial goods and dual-use goods)	Potential increase in re-exports to Russia from third countries	Risk of the Kazakhstan enterprises falling under sanctions	Risk of the Kazakhstan enterprises falling under sanctions / toughening of the trade policy towards RK / ban on supply of the dual-use goods
Boycott	Outflow of the brands from Russia (mainly, consumer sector)	Restoration and development of own production. Re-exports to Russia from third countries	Risk of the Kazakhstan enterprises falling under sanctions	Risk of the Kazakhstan enterprises falling under sanctions / toughening of the trade policy towards RK / ban on supply of the dual-use goods
Sanction/Decision of the Russian authorities	Export ban on a number of the Russian goods	Potential disruption of the goods supply from the RK (metals, agricultural products, etc.).	Stoppage of the export goods supplies from the RK (metals, agricultural products etc.).	Ban on exports from the RK (metals, agricultural products etc.).
Decision of the Russian authorities	Ban on exports of sugar, cars and wheat	The restriction is temporary, and exceptions are made for EAEU countries. But the final decision is taken by the Russian government	Short-term shortages of sugar and transport - domestic market dependence on the Russian supplies is high	Sugar and transport shortages
Boycott	Refusal to provide the services (treatment, system maintenance, licensing tools, social media, etc.)	Problem with implementation of joint projects with Russia due to different level of technical availability	Potential IT degradation, growth of unemployment in the sectors, falling quality of the services	Expansion of blocking also applies to Kazakhstan, with the expected results

## Social consequences

Consequences	As is	Bad	Worst
Inflation import	The prices continue increasing, due not only to imported inflation, but also to weakening of <u>Tenge</u> and rising inflation expectations.	Inflation accelerated to 25% p.a., attempted containment through export ban and price ceilings. Significant decline in purchasing power of the population.	Inflation surge up to 50%, shutdown of businesses, impoverishment of the population, depreciation of the savings.
Migration to Kazakhstan	Potential increase of pressure on the Kazakhstan <u>labour</u> market. Primarily, on the part of the qualified personnel.	Increased pressure on the RK <u>labour</u> market on the part of the skilled personnel from Russia and low-skilled workers from the Central Asian countries	Increased pressure on the RK <u>labour</u> market on the part of the low-skilled workers from Russia and the Central Asian countries
Re-registration of the enterprises to Kazakhstan	Companies from Russia consider Kazakhstan as one of the options for tax (and sometimes physical) residence. For the most part these are small businesses, the work of which is not physically linked to the commodities and local markets - for example, IT. But so far Kazakhstan is losing competition to Georgia and Armenia.	Physically relocated Russian companies solicit the <u>labour</u> force, leaving Kazakhstan companies with staff shortages. At the same time they continue working for Russia.	
Shortage of the medicines	Short-term interruptions in the medicines supply caused by disruptions in the supply chains.	Frequent interruptions in the medicines supply caused by disruptions in the supply chains.	Shortage of the medicines caused by breach of the supply chains; ban on supplies of the range of the medicines and medical equipment
Currency outflow to Russia	Demand for foreign currency (dollars) on the part of population, which cannot be covered by the banks in time.	Russian population goes to Kazakhstan for currency, increasing demand for it, and thus putting pressure on the exchange rate.	Too much external pressure forces the National Bank to limit the volume of currency transactions for people in Kazakhstan as well. This also applies to business, which is forced to sell a part of their foreign currency earnings at the domestic market.
Stoppage of production in the RK (imports of the commodities/components from the RF, Russia as main sales market, etc.)	Potential suspension of the operations to work out new logistics	Shutdown of the enterprises with dismissal of the workers (possible change of the owners)	Closure of the enterprises with dismissal of the employees
Decrease in the well-being of the population	Government announces a future increase in the public sector wages (but this was planned in advance), the deposits in banks are supplemented with additional guarantees	Inflation overtakes the growth of the wages, people become poorer. Jobs are decreasing at least because of reduction in demand	The population is getting poorer, the factories are standing idle, and there is almost no own production. Unrest provoked by these factors.
Involvement in the hostilities by the CSTO.	While this is out of the question, Kazakhstan is distancing itself from such measures.	Kazakhstan sends few forces to Ukraine. The boycott and sanctions extend to Kazakhstan.	Fighting is spreading to the territories of the CSTO countries, including Kazakhstan. The boycott and sanctions extend to Kazakhstan.

## Social consequences prevention measures

Consequences	Measures	Risks	Possibilities
Inflation import	Socially important goods price control; subsidies for the retail chains; and utilities and fuel price freezing.	Artificial price controls can make production and trade in a number of the commodities unprofitable, resulting in shortages. The moratorium on growth of the services and fuel price cannot last forever, and sharp rise in the prices following its abolition in January 2022 has already led to a social upheaval.	Not only finished goods are becoming more expensive, but also the raw materials. In sectors where Russian dumping has traditionally been high (sugar, dairy, etc.), this could be an incentive to switch to a domestic base and develop it.
Migration to Kazakhstan	Increase of the quotas for foreign <u>labour</u> force with stricter requirements for them. Tougher control over compliance with the migration legislation	Exports of unemployment	Outflow of top management (qualified personnel) and dedicated specialists, shortage of whom is observed on the domestic market.
Shortage of the medicines	Conclusion of the memorandums with major global pharmaceutical companies on the medicines supplies to Kazakhstan. Development of own production facilities, including by transferring capacity from Russia. Introduction of the ceiling prices for the main items	Artificial price control can make production and trade in the medicines unprofitable, resulting in increasing shortages.	Development of own production, including by attracting the capacities of the companies that reduce production in Russia.
Currency outflow to Russia	Restrictions on the exports of currency and gold. Restrictions on the purchase of foreign currency. Transition to <u>Roubles</u> and <u>Tenge</u> in mutual settlements with Russia.	The measures should be temporary, as they threaten emergence of <u>grey</u> /black currency market.	
Stoppage of production in the RK (imports of the commodities/components from the RF, Russia as main sales market, etc.)	Tax holidays for the exporting enterprises. Increased share of the domestic goods in procurement by the state-owned companies and quasi-sector. Temporary imports restrictions	Decrease of the budget revenues. Potential increase of the commodity shortage on the domestic market and general reduction of the product quality against the background of lower external competition.	Re-orientation towards other sales markets. Increase of the Kazakhstan content share at the domestic market. Development of the downstream industries. Reduced dependence on Russia in foreign trade.
Decrease in the well-being of the population	Raising the salaries of the public-sector employees. Creation of new jobs through development of the industrial (processing) sector.	Inflation neutralizes the nominal income growth of those who had it, and makes those who did not have it poorer.	Traditionally, in times of crisis, the government <u>programmes</u> are launched to support some sector with mass employment (most often, construction - housing, infrastructure, etc.) with preferential loans to ensure demand. Option - preferential loans for the processing sector.