Sanctions and Currencies in Global Credit

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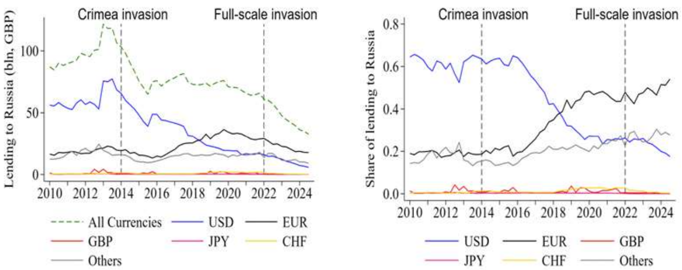
Abstract

This paper studies how *sanction risk* affects the allocation of cross-border credit, the dominance of the U.S. dollar in global credit markets and, ultimately, the oversight of hegemonic powers on global financial intermediation. We document that, between 2014 and 2021, global cross-border claims on Russia de-dollarised, as coordinated EU and US financial sanctions partially restricted access to Western credit for a sub-set of Russian firms. We explain this with two frictions induced by financial sanctions —jurisdictional and currency-specific. The latter arises from the global oversight of U.S. authorities on any transaction clearing via U.S. dollar payment systems. First, we show that the rise in euro-denominated claims was entirely accounted for by non-sanctioned Russian firms. Second, we find that banks whose ultimate parent was headquartered in a sanctioning jurisdiction reduced their claims on Russia by 20–40% relative to other banks. However, all banks—regardless of ultimate jurisdiction—increased Russian claims in euros relative to dollars. Third, we find a negative premium on loan pricing in euros relative to U.S. dollars, and a concurrent rise in euro loan volumes. Finally, we show that U.S. financial geo-economic power on Russia, defined as the share of controlled financial intermediation, was mostly driven by use of the U.S. dollar by non-U.S. banks and that it declined from 97% in 2013 to 69% in 2021.

Euroisation of Global Claims on Russia

Between 2014 and 2021, the USD share of cross-border lending to Russia decreased from 65% to 25%. The corresponding share in euros increased from 20% to 45%.

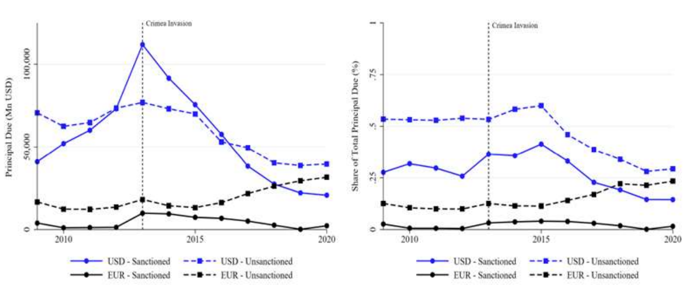


(a) Total Lending and Currency Breakdown (b) Shares of Lending by Currency

Figure 1. Global Cross-Border Lending to Russia by Currency.
Source: BIS locational banking dataset, Authors' calculations.

Firm-level Evidence

Using detailed firm-level debt-structure data, we show that the rise in euro-denominated claims was driven entirely by non-sanctioned Russian firms.



(a) USD and EUR Principal Due (b) Share of Principal Due in USD and EUR

Figure 2. Debt Profile and Currency Composition of Russian Firms by Sanctioning Status.
Source: Capital IQ, Authors' calculations.

Bank-level Evidence

We disentangle jurisdictional from currency frictions using confidential bank-level data covering the universe of cross-border claims of banks resident in the UK. Banks whose ultimate parent was headquartered in a sanctioning jurisdiction reduced their claims on Russia by 20–40% relative to other banks. However, all banks—regardless of ultimate jurisdiction—increased Russian claims in euros relative to dollars, by a factor of about 4. Russia-exposed banks, defined based on their pre-sanctions exposure at end-2013, subsequently reduced their claims on other emerging markets along the same dimensions, relative to non-exposed banks.

$$
\begin{aligned}
l_{bcdt} = \exp\big(& c + \omega_{bcd} + \kappa_{ct} + \chi_{dt} + \tau_{bt} + \gamma_1 \cdot \text{Currency}_c \times \text{Post}_t \times \text{Russia}_d + \\
& \gamma_2 \cdot \text{Jurisdiction}_b \times \text{Post}_t \times \text{Russia}_d + \gamma_3 \cdot \text{Currency}_c \times \text{Post}_t \times \text{Jurisdiction}_b \times \text{Russia}_d + \\
& \gamma_4 \cdot \text{Jurisdiction}_b \times \text{Post}_t + \gamma_5 \cdot \text{Currency}_c \times \text{Post}_t \times \text{Jurisdiction}_b \big) + \nu_{bcdt}
\end{aligned}
$$

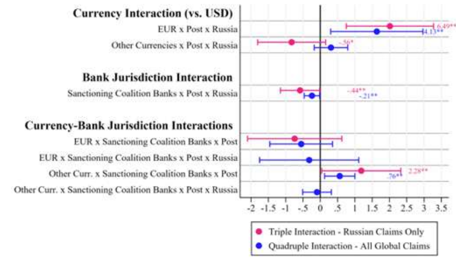


Figure 3. Estimated Effect of Jurisdiction and Currency Frictions within Bank-Destination-Currency.
Source: Bank of England's dataset on claims of UK banks on non-residents, Authors' calculations.

Loan-Level Evidence: Prices and Quantities

We analyse prices and quantities in the syndicated-loan market for Russian borrowers after 2014. We find a negative premium on loan pricing in euro vs. USD—about 30-50 basis points for the same firm borrowing in both currencies in the same period—and a concurrent rise in euro loan volumes, consistent with a high degree of substitutability between vehicle currencies in this specific context.

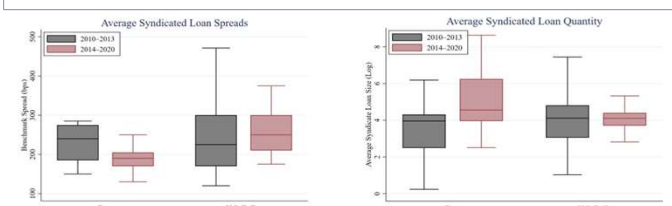
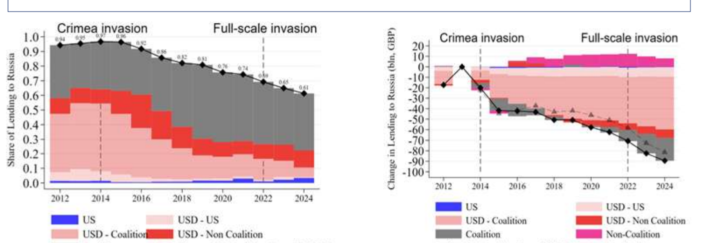


Figure 4. Average Firm-Bank Prices and Quantities for Russian Borrowers.
Source: DealScan, Authors' calculations.

Geoeconomic Power

Using BIS locational banking data by nationality and currency, we provide a new capital-flows perspective on measuring geoeconomic power —the share of financial intermediation controlled by a hegemon. U.S. financial geo-economic power on Russia was mostly driven by use of the U.S. dollar by non-U.S. banks, and it declined from 97% in 2013 to 69% in 2021.



(a) Share of Lending under U.S. Geoeconomic Power (b) Change in Lending under U.S. Geoeconomic Power

Figure 5. U.S. Coalition Controlled Claims - Nationality Basis.
Source: BIS locational banking dataset, Authors' calculations.

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