

The Implications of the Russia-Ukraine Conflict on International Banking

Guanzhong He*

Faculty of business and Economics, Monash University, Melbourne, Australia

*Corresponding author: ghee0005@student.monash.edu

Abstract. This study analyzes the implications of the Russia-Ukraine conflict on the international banking industry. The study establishes that the economic sanctions imposed on Russia have gravely affected the international banking sector. Primarily, the study highlights that the US government implemented a sanction that prohibits the Central Bank of Russia from using the US dollar for payments. This move has rendered all the reserves by the Russian government and its citizens, which are kept in US dollars worthless and inaccessible, leading to huge losses for domestic and international banks. Moreover, this study outlines that banning Russian financial institutions from using SWIFT has limited the financial payments that are being completed in the global banking sector between Russian consumers and companies, and other merchants across the world. This study also establishes that the withdrawal of services by Visa, MasterCard, American Express, and Paypal from the Russian economy as a protest against Russia's invasion of Ukraine has led to a decline in revenues for international banks. As a measure to mitigate the adverse implications of economic sanctions on sovereign states in the future, the study suggests the adoption of diverse global payment systems such as CIPS and SPFS, which can cushion the international banking industry against the potential adverse effects of being denied the right to use the world's dominant currencies and the SWIFT messaging system to make payments.

Keywords: Russia-Ukraine conflict, COVID-19, Society for Worldwide Interbank Financial Telecommunication (SWIFT), System for Transfer of Financial Messages (SPFS), Economic sanctions.

1. Introduction

The conflict between Russia and Ukraine, which began on February 24, 2022, has had a massive economic and social impact on the citizens of the two countries and the entire world. The Russia-Ukraine conflict, which is undoubtedly the most significant dispute in Europe in the post-World War II era, has come at a sensitive time for the global economy when the world is figuring out the best way to mitigate the economic effect of the COVID-19 pandemic [1]. The Russia-Ukraine conflict has dimmed the hope of achieving economic recovery from the ravages of COVID-19. The notable global economic strains resulting from the COVID-19 pandemic, including surging inflation, high unemployment rates, tangled supply chains, and tumbling financial markets, have been worsened by the unforgiving effects of the war between Russia and Ukraine [2].

While the world is grappling with the adverse economic consequences of COVID-19, the Russia-Ukraine war has magnified the threat of a downturn in the global banking sector. Supporting this argument shows that the repercussions of the Russia-Ukraine war are threatening the global economy, particularly the banking industry, by sparing unprecedented uncertainty in the world's financial markets and supply chain processes [3]. The economic sanctions, increased prices for commodities, and gross disruptions in the supply chain sector, are the primary implications of the Russia-Ukraine conflict on the global banking industry and the economy in its entirety [4]. Since the banking sector is the custodian of financial resources in the formal sector, disruptions in the financial markets, supply chain processes, and foreign exchange operations have a significant ripple effect on the international banking industry. Hence, this study analyzes the removal of Russia from the global financial system, disruption of the global supply chain system, and curtailing of global payment platforms as the main implications of the Russia-Ukraine conflict on international banking. The research analyzes the

adoption of SPFS and CIPS as a practical solution for the potential challenge that the international banking sector can experience following the imposition of sanctions against sovereign states.

2. Removing Russia From the Global Financial System

2.1 Restricts Russia's US dollar reserves

The United States and many global economic powerhouses such as the United Kingdom have imposed massive sanctions on Russia due to the unjustified invasion of the Ukrainian territory. For instance, cutting off trade ties between the United States and Russia has made all dollar reserves owned by Russia worthless. Russia can no longer use the US dollar currency on its payment systems following the economic sanction imposed on her by the US government in response to the Russia-Ukraine war [5]. The United States has implemented a special section that prohibits the Russian Central Bank from using the US dollar to complete financial transactions or payments [6]. Moreover, the US government has completely blocked the Russian direct investment fund as a strategy to prevent the European country from thriving economically by trading using the world's most dominant currency, the US dollar. The report published on CNN indicates that the move by the US to ban the use of US dollars by the Russian Central Bank implies that Russia cannot access all the funds it has stored in its financial reserves in US dollars. At the time when this sanction was imposed, Russia had \$630 billion in reserves, which were rendered worthless in immediate effect.

2.2 Russian Banks are forbidden to use SWIFT

Russian banks were also barred from using SWIFT. SWIFT stands for the "Society for Worldwide Interbank Financial Telecommunication", which is a global messaging system connecting thousands of formal financial institutions across the world [7]. SWIFT, which has its headquarters in Belgium, is owned jointly by more than 2,000 financial institutions and is governed by the National Bank of Belgium in collaboration with Central Banks of the United Kingdom, Germany, France, Sweden, Italy, the United States, Sweden, and the Netherlands [8]. Cutting off the Central Bank of Russia from SWIFT denies Russian financial institutions the chance to use a globally standardized communication system that connects thousands of banks and financial institutions across the world to complete financial transactions domestically and internationally [8]. Therefore, barring Russia from using SWIFT makes it hard for Russian businesses, entrepreneurs, and banks to participate in the global economy by curtailing their ability to freely complete financial transactions across banks in other parts of the world [9]. SWIFT connects over 11,000 financial institutions in more than 200 countries worldwide [8]. Hence, removing Russia from the SWIFT system prevents Russian financial institutions from operating effectively, connecting easily, and transacting in billions of different currencies between companies and governments within the international banking system [8].

2.3 The impact of barring Russia from using SWIFT

It is worth noting that cutting Russia off from the global financial system hurts the Russian banking sector as well as the international banking industry. For instance, the Bank of New York Mellon (BNY Mellon) reported a 3% decline in its first-quarter earnings in 2022 due to the economic effect of the Russian-Ukraine conflict [10]. Specifically, BNY Mellon recorded a loss of \$88 million, which is largely attributed to the sanctions imposed by the United States against Russia, resulting in a loss of depository receipt services for Russian companies and businesses [10]. BNY and other financial institutions across the United States and European countries, which ceased business with Russia in response to the sanctions imposed by their respective governments against Russia in protest of its unprovoked invasion of Ukraine, experienced massive losses over time. The international banking sector is projected to experience a significant decline in revenues over the foreseeable future due to the cutting off of Russia from the global financial system [11].

3. Reduced Payments For Imports and Exports

Russia and Ukraine are among the world's leading producers and exporters of certain products. For instance, Russia, and Ukraine were responsible for 60% of the global production of sunflower oil in 2021. The two countries also accounted for 28% of wheat exports across the world in 2021 [12]. Generally, Russia and Ukraine are known for producing and exporting a wide range of valuable commodities to the world, including natural gas, palladium, nickel, coal, wheat, fertilizers, platinum, crude oil, aluminum, seed oil, and corn (see figure 1). All payments for exports and imports, between private companies and governments, are completed through banks.

The Russia-Ukraine conflict has greatly disrupted the global supply chains [11]. Russian exports are restricted due to the sanctions imposed on her. Since many countries across Europe and the rest of the world rely on Russia for oil and gas, the trade sanctions imposed on Russia have affected the free export of these important commodities from Russia to the rest of the world. Similarly, countries relying on Ukraine for the supply of wheat, seed oil, and corn have also been hit hard by the Russia-Ukraine conflict. Thus, the conflict between these two countries has led to reduced export and import payments for banks in Russia, Ukraine, European countries, and the United States [16].

Shockwaves for global trade

Some developing economies are heavily reliant on Russia and Ukraine for food
Ukraine and Russia's commodity exports as a percentage of global exports

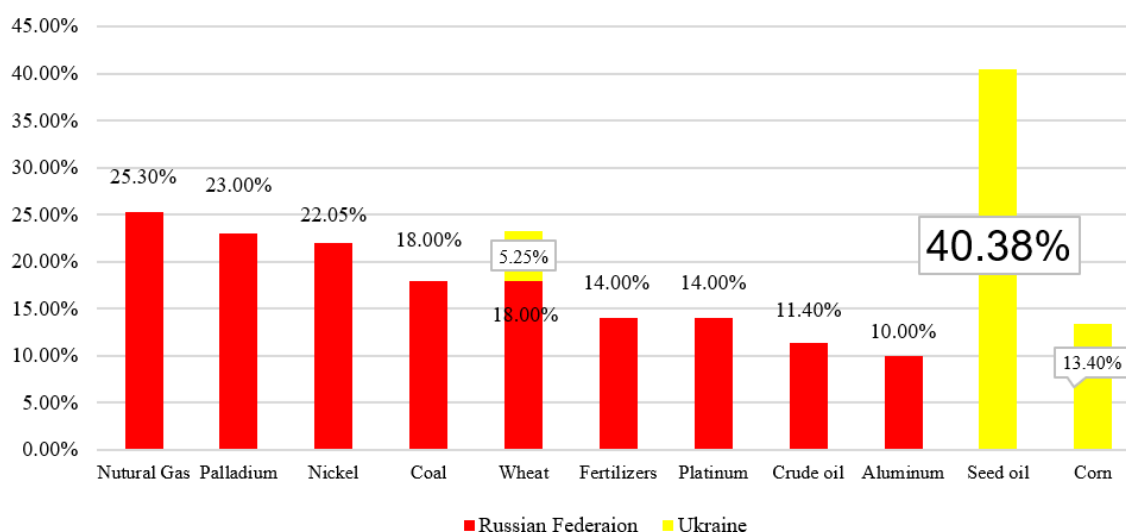


Fig. 1 A percentage of the global export accounted for by Russia and Ukraine in the first quarter of 2022

Since the international banking system is the primary moderator of trade operations between Russia, Ukraine, and the rest of the world, it is justifiably arguable that the disruption of the global supply chain due to the Russia-Ukraine war has adversely affected the operations and profitability of financial institutions in the international market. Banks in Europe and the United States that completed payments for exports and imports of commodities between companies and governments of Russia and Ukraine experienced a decline in revenues. The reduced export activities in Russia and Ukraine due to the economic sanctions imposed on Russia and the instability of the Ukrainian economy have negatively impacted the global supply chain in the oil, gas, and other staple commodities sectors of these two countries, reducing the revenues and profitability of international banks that mid-wife these export and import transactions/payment [15].

4. Curtailed Global Payment Platforms

Some of the global leading payment platforms ceased operations in Russia as a protest against her invasion of Ukraine. Visa, MasterCard, American Express, and Paypal announced a suspension of their operations in Russia in protest against its invasion of Ukraine [13]. The withdrawal of business by many payment firms from the Russian economy has a significant impact on the global banking industry. Financial institutions in Russia use Visa, MasterCard, and American Express to complete transactions for their clients. While the withdrawal of these major payment services from Russia may not have an immediate impact on the country's economy since consumers will be able to use these cards to make payments within Russia until they reach their expiry dates, the negative impact of these withdrawals on Visa, MasterCard, and American Express as international companies is inevitable. Cards issued by these companies abroad cannot operate in retail outlets and ATMs in Russia [13]. Similarly, clients who have Visa, MasterCard, and American Express cards issued to them by Russian financial institutions cannot use them to make payments to international merchants on online platforms or in physical outlets such as retail shops and ATMs outside Russia [13]. The restriction in payments that can be completed through Visa, MasterCard, and American Express due to the sanctions imposed against the Russian economy is likely to have a significant negative impact on overall revenues for banks in the international market, particularly by reducing the number and frequency of overall transactions completed through ATMs by Russian and international consumers across the world.

5. Solution and Conclusion

The international banking sector should implement measures for mitigating the adverse effects of the Russia-Ukraine war on its operations. One of the strategic solutions that Russia and the rest of the world can implement to mitigate the potential adverse effect of being cut off from the global financial system is reducing the reliance on the US dollar and other foreign currencies for payments. Countries can achieve this by supporting alternatives to the SWIFT messaging system. For instance, China has implemented the Cross-Boarder Interbank Payment System (CIPS), which is an independent international Youan payment that is used across 103 countries [9]. Moreover, Russia has developed a comprehensive messaging and payment system known as the System for Transfer of Financial Messages (SPFS), which is used to complete payments in Russia, Cuba, Kazakhstan, Tajikistan, and Belarus [14].

Systems such as SPFS and CIPS provide alternative messaging systems to SWIFT and can help the international banking system to remain on its feet even when barred from using the SWIFT system or any other specific dominant global messaging system that connects financial institutions across different countries. Generally, having multiple payment systems can help to diversify the risk of using a single payment network such as SWIFT, which puts the international banking system at a huge risk of financial loss when specific countries are barred from using them. Additionally, the development of other reliable international payment systems that are based outside the United States and Europe can build the capability of the global banking system to complete payments in currencies other than the US dollar, Euro, or Great Britain Pound that can be used by global economic powers to sanction countries and interfere with the operations of the international banking system.

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