# Capital markets become serious problem for Russia

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April 17, 2014

As tension persists between Russia and the West over Ukraine, international markets' view on Russian bonds has turned increasingly icy.

Yields on ruble-denominated 10-year bonds have jumped 94 basis points since Russia's incursion into Ukraine's Crimea region at the start of March. Citing lack of demand and "unfavorable market conditions," Russia has already scrapped eight bond auctions this year, with the latest such cancellation coming earlier this week.

Russian officials have stressed that the nation, with nearly $500 billion in reserves, can afford to wait for funding—and markets for the Russian ruble and U.S. Treasurys breathed a sigh of relief over what appeared to be diplomatic progress between Russia and the West on Thursday. But some see Moscow's recent stop-and-go approach to bond auctions as just the latest in a string of ominous signals for Russia's capital markets.

"Russia can afford to work it out for some time, but this is now the eighth bond auction that's been canceled," said Nicholas Spiro, managing director of Spiro Sovereign Strategy, a sovereign credit risk consultancy. "There's an inescapable feeling that the credibility of the Russian policy regime is starting to suffer."

Dalibor Rohac, a policy analyst at the Cato Institute, agreed.

"The auction cancellations don't mean that Russia is getting insolvent, but it's a signal that things aren't getting on that well in the economy," he said. "There is a price to pay for foreign policy adventure."

That price, coming in the form of higher bond yields, has been a major reason behind the bond auction cancellations, said Apostolos Bantis, an emerging markets credit strategist at Commerzbank.

"Investors are demanding a higher premium, which the Russians are not willing to offer," said Bantis. "They do not want to lock into a high premium right now."

Yields on Russia's 10-year bonds are above 9.1 percent this week, and reached nearly 9.8 percent last month.

Spiro said that for now, Russia's government remains self-assured about its cancellation of bond auctions in the face of negative sentiment from investors.

"They clearly believe that market conditions are going to improve, and that this is a manageable situation, that they can afford to scrap these bond auctions," said Spiro, who spoke with CNBC before seemingly positive diplomatic developments between Russia, the U.S., the European Union and Ukraine. "But Russia has crossed a Rubicon here. Perceptions of Russia's investment climate were bleak to begin with, and now it is quite conceivable that Russia has done itself irreparable damage here in terms of Western investment."

Any short-term progress for Russia's economy in international markets could easily yield to long-term paralysis in the event of a hot war in Ukraine, cautioned the Cato Institute's Rohac.

"In the event that tension in the Crimea and Ukraine escalates, the capital markets situation will look much bleaker for Russia," he said. "If they can't sell bonds now, how will they sell them if there's an open war?"

*—By CNBC's Adam Molon*