RUSSIA'S ECONOMY ALONGSIDE THE WAR

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Russia's Economy alongside the War

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Executive Summary

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Russia is sustaining its newly formed war economy and has to endure the effects of Western sanctions. Indeed, these sanctions have had an important strike on some key weaknesses of the Kremlin's economy, such as its strong resilience on fossil fuel exports or its weak and volatile currency. Sanctions such as the ban on Russian oil in Europe or an international price cap of 60$ on Russian oil barill have had significant blows on Putin's finances. Arguably, the most efficient sanction so far has been freezing Russia's foreign assets, preventing Moscow from using its foreign currency reserve to finance its war economy with dollars. Despite the many sanctions, Russia is still on its feet, with a GDP growth rate in 2023 of 3.6%, as President Putin said "They won't succeed! Our economy is growing, unlike theirs."[1]

Russia has been able to absorb these sanctions and finance the war without too much damage to its economy. Moscow has been supporting the main drivers (the defense, banking, and energy sectors) of its economy since the invasion of Ukraine by subsidizing these critical industries. Consequently, Moscow has created hundreds of thousands of jobs sustaining the war effort. However, this large government spending comes at a cost: inflation. The constant intervention of Russia in the defense and energy sector and the important volatility of the Ruble have been why Russia's Inflation reached 8.5% in 2023. To offset this inflationary pressure, Russia's central bank has been raising interest rates at a record level to around 21% without any success so far. [2]

To protect its oil and gas exports from the sanctions and ensure stable and continued revenue streams, Russia circumvented most trade-related sanctions by shifting its trade relations from its past Western partners toward the BRICS. On top of that, the Russian energy industry has benefited from high oil and gas prices since the breakout of the war, boosting the Kremlin's revenues.

In the following years, Russia's economy is expected to experience stagflation (a combination of low GDP growth and high inflation). According to our guest speaker Alexander Kolyandr, the most likely scenario for Russia's economic future is modest growth of 1.8% to 2%, accompanied by high inflation. Overall, Russia has been extremely resilient and should remain so in the future. Despite challenges such as inflation, labor shortages and ongoing sanctions, Russia has never been so close to proving that it can survive in face of the west.

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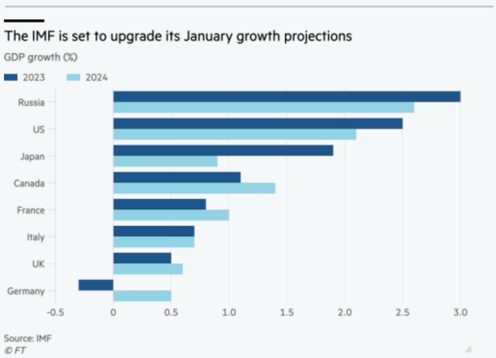

https://www.ft.com/content/d304a182-997d-4dae-98a1-aa7c691526db

https://madan.org.il/en/news/west-vs-russia-clash-narratives

State Capitalism: An economic system in which the state uses and controls the free-market system to protect its political regime through leading economic activities

BRICS: The BRICS are a group of emerging economies whose brisk expansion has outstripped that of more developed markets recently

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Introduction

Prelude

The ongoing Russia-Ukraine war has emerged as one of the twenty-first century's most significant geopolitical and economic crises. What began in 2014 as Russia's invasion and annexation of the Crimea peninsula, in Ukraine, has escalated into one of the deadliest and largest conflicts since World War II. This war has not only cost the lives of many civilians and military, and the destruction of cities and their infrastructure, but it has also had a major effect on the global economy. Western allies, including the United States, NATO, and the European Union, have provided substantial military and financial support to Ukraine while imposing severe economic sanctions on Russia. These sanctions, primarily targeting Russian exports, aim to weaken the country's economic base by focusing on key sectors such as energy, technology, and finance. However, despite these measures, Russia has managed to sustain its war efforts by capitalizing on rising oil, gas, and other commodity prices. Elevated crude oil prices, in particular, have allowed Russia to maintain significant revenue streams, underscoring the complex interplay between geopolitics and global energy markets.

This economic research paper aims to analyse the resilience of the Russian economy given the war and international sanctions. It will examine how one of the world's largest countries, with an estimated GDP in 2023 of $ 8.22 trillion dollars, has financed and sustained its continued war efforts, particularly through oil production and new trade partnerships. In addition, the paper will also address some of the main socio-economic and geopolitical challenges the war has introduced. By focusing on these, this analysis will seek to provide a complex understanding and interplay between the economic and political dynamics that occur within a country that is facing war. In order to conduct a deep research analysis, an interview was carried out by the research team with a financial analyst and a non-resident senior scholar at the Centre for European Policy Analysis (CEPEA), Alexander Kolyander. Through this paper, we have included and quoted some of his insights as part of the analysis, to further deepen our insights.

https://www.aljazeera.com/news/2022/2/28/russias-invasion-of-ukraine-list-of-key-events-from-day-5

https://www.independent.co.uk/news/world/europe/newspapers-ukraine-russia-kyiv-invasion-b2023049.html

https://www.npr.org/2023/08/24/1195733556/why-a-weak-ruble-is-good-for-russias-budget-but-not-putins-image

Context: Russia’s invasion of Ukraine

In February 2014, Russia invaded and annexed the Crimea Peninsula. This erosion of Ukraine’s territorial integrity marked the beginning of the Russia-Ukraine conflict. This conflict remained limited in scale until February 2022, when, after years of escalating tensions, Russia launched a full-scale invasion of Ukraine, which resulted in the largest and deadliest conflict in Europe since World War II. Since then, *hundreds of thousands of Russian and Ukrainian troops, along with tens of thousands of Ukrainian civilians, have been killed or permanently disabled. [1]*

The origins of the Russia-Ukraine war traced back to the breakup of the Soviet Union, which once connected the two countries under a single state. Experts attribute the invasions to a complex mix of historical ties, Russia’s tensions with the North Atlantic Treaty Organization (NATO), and Vladimir Putin’s ambitions. Under Putin's leadership, Russia has shifted from being a fragile democracy to an increasingly authoritarian regime. As a result, Russia’s desire to regain influence over former Soviet territories clashed with Ukraine’s growing ties to the West, heightening tensions and concerns about democratic movements near Russia’s borders. This tension ultimately transformed into a prolonged war, devastating Ukraine’s infrastructure and economy and triggering global economic and political consequences.

Following the invasion in 2022, Russian forces initially captured key areas of Ukraine, including Kherson and parts of the Donbas region. However, with substantial aid from allies, Ukraine managed to reclaim significant territory, turning the conflict into a prolonged war of attrition. Despite Ukraine’s counterattacks, which have reclaimed 54% of the previously occupied areas, Russia still holds critical regions. Currently, Russia continues its assaults on Ukrainian cities and infrastructure, with massive missile and drone attacks.

https://www.bbc.com/news/world-europe-60506682

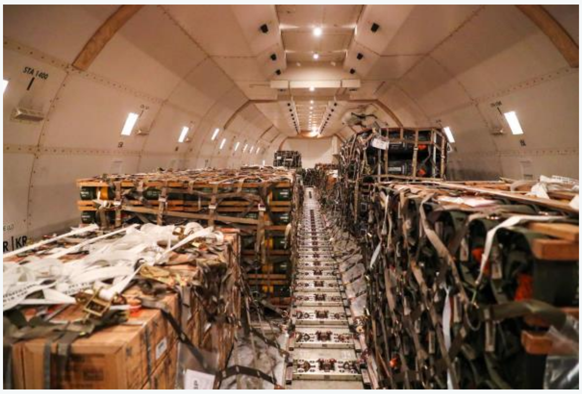
Context: Russia's invasion of Ukraine

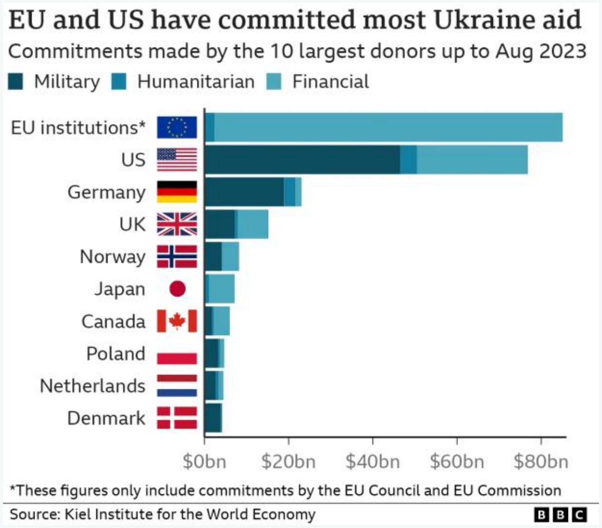
The US is the country that has provided the greatest aid to Ukraine. It is estimated that since the 2022 invasion, the US government has given $175 billion in aid, with $106 billion directly provided to the government of Ukraine and the remaining funding various related activities and regional support. [2]

Other key allies, including NATO and the EU, have also provided large amounts of aid. Most of this assistance has been directed toward providing weapons systems, training, and intelligence that Ukrainian militaries need to defend against Russia, which has one of the world's most powerful militaries. Between 4,000 and 7,000 Ukrainian artillery rounds are being shot every day, which showcases the current large scale and brutality of the war, but Russian forces shoot about two to four times that amount. [3]

Moreover, it has recently been revealed that North Korea is now actively supporting Russia by deploying thousands of elite troops marking an alarming new phase of cooperation between Moscow and Pyongyang. Moreover, China's ambiguous stance on this alliance adds to Western preoccupations, potentially straining its trade relationships with the European Union.

Overall, this war has brought negative consequences that are impacting not only the geopolitics of Russia but have also resulted in a global response in which different countries around the world are implementing sanctions to isolate Russia. The following sections of this paper aim to examine and analyse the resilience of the Russian economy in the face of sanctions being imposed by other countries.





https://www.bbc.com/news/66870559

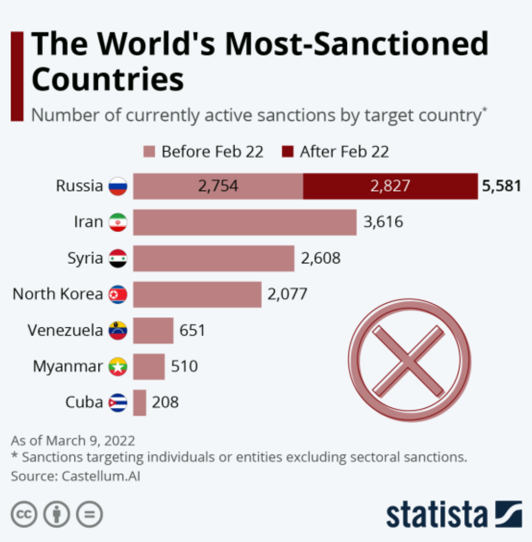
Sanctions

Since Russia invaded Crimea in 2014, several countries have imposed and intensified financial, economic and diplomatic sanctions on Russia. Further sanctions were added on Russia following its full-scale invasion in 2022. Specifically, between the US, the UK, the EU, Australia, Canada and Japan, more than 16,500 sets of sanctions have been imposed. These sanctions aim to weaken Russia's economic base. It should be noted that sanctions have been imposed on large institutions and individuals with influence in the Russian government. A total of 1,473 individuals and 207 entities are on the targeted sanctions list. [1] The vast majority of sanctions can be recollected in 4 big sanctions packages.

Financial Sanctions: The major sanction related to financial resources is the disconnection of Russian banks from the international SWIFT system. This system allows banks to communicate with each other securely, thus increasing their operational capacity. This has limited the operability of Russia's largest banks, thereby hurting and fragilising Russia's economy.

Russian Central Bank asset freeze: The Russian Central Bank has been prevented from being able to use its foreign exchange reserves, the aim of this is to undermine Russia's ability to finance its war. Joe Biden, former president of the United States, announced that "We will limit Russia's ability to all Business in dollar, euro, pounds and yen". On the other hand, assets of entities and persons on the EU list have also been frozen. Consequently, since 2022 Russia's Central Bank has been unable to use its $350 billion of assets. As for targeted individuals, up to $21.5 billion of assets (located in Europe) have been frozen, aiming at preventing people with high economic capacity from financing the war with their own assets.[2]

Sanctions on the energy sector: These sanctions are mainly based on oil, which is the main driver of the country's economy. It should be noted that thousands of sanctions have been applied in this sector. The most important sanctions of this type concern the maritime transport of Russian oil and oil products (capping the price per barrel at $60), as well as the ban on importing crude oil or providing gas storage capacity to Russian nationals.



https://www.statista.com/chart/31560/newly-imposed-sanctions-against-russia-per-month/

https://www.businesstoday.in/latest/world/story/ukraine-crisis-list-of-countries-that-have-imposed-sanctions-on-russia-323591-2022-02-23

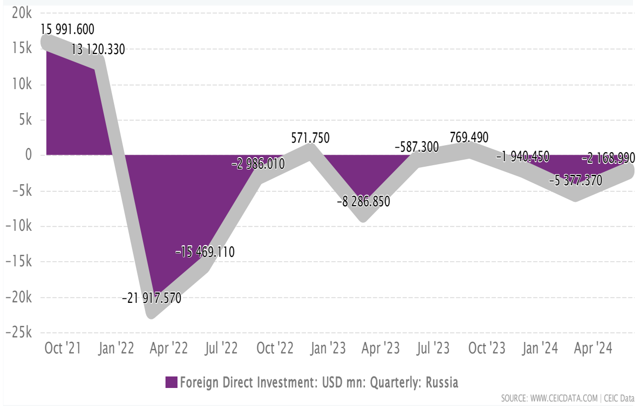
Sanctions on the Tech Sector: G7 countries have banned exports to Russia of Dual-use technology, Military equipment, Refinery Technology, or Mining Investment. These sanctions limit Russia's main economic sectors, thus affecting Russia's GDP. As a result, Russia’s Finance Minister, Anton Siluanov, stated in 2022 that an increase of 1.1% of the deficit was expected.[3]

Closure of airspace and transport restrictions: The EU together with other countries have closed their airspace to all Russian-owned aircraft. In addition, bans have been imposed on: the entry of Russian vessels to ports, and the export of goods and technology in the aviation, maritime and space sectors to Russia, among others... On the other hand, the persons mentioned above who are part of the sanctions list cannot enter or transit through the territory of the EU. These limitations hinder mobility, both for people and goods, thus affecting the ease of obtaining resources.

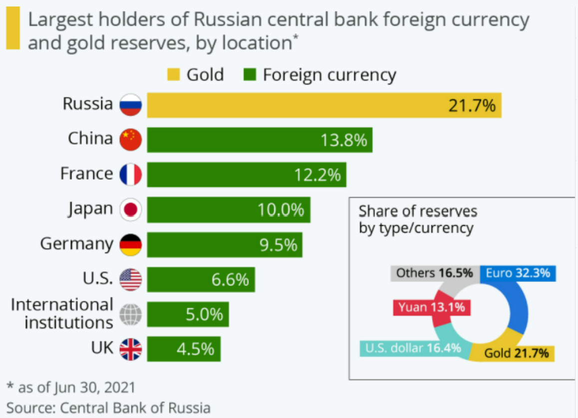
These sanctions have had a significant effect on Russia's economy. As a result, Foreign Direct Investments have been negative since February 2022. Russia’s exports have decreased by 32% and its oil revenues have decreased by 40% in February 2023 compared to February 2022. These sanctions, as can be seen, have affected key sectors of the Russian economy. [4] Therefore, the US Treasury has said that these measures have had a direct effect on the country's economic growth, reducing it by 5%. In addition, inflation rose by 7.1% in February 2023, impacting not only the country's economic capacity but also the purchasing power of its citizens. Finally, it is also important to mention that the sanctions have caused the Russian ruble to depreciate by 30%.

According to Alexander Kolyandr, “the most damaging of them (referring to the sanctions) is the one applied against Russia’s Central Bank, which prevents Russia from using and trading with dollars”. Indeed, without access to strong currencies such as the euro or the dollar, implementing monetary policy in Russia can be hard. As a consequence, the volatility of the Ruble has increased significantly since Russia’s monetary policies are not backed with foreign assets. More importantly, it also reduced access to liquid and stable foreign assets that could have been used to finance its war against Ukraine.

https://cbrn-risk-mitigation.network.europa.eu/eu-p2p-export-control-programme/dual-use-trade-control_en



https://www.ceicdata.com/en/indicator/russia/foreign-direct-investment



https://www.statista.com/chart/26940/russian-central-bank-foreign-currency-and-gold-reserves-by-holder/

Dual-use technology : Dual-use items are goods, software and technology that can be used for both civilian and military applications.

Russia’s Economy

Sector Analysis

Emerging-market economies like Brazil, Russia, India, or China may have been of interest to investors seeking more diversity or attempting to access rapidly expanding regions of the world. Russia is undoubtedly the largest of them in terms of land, but it only ranks 11th in terms of global gross domestic product (GDP), just ahead of Mexico (12th) and well behind China (2nd) and the United States (1st). Russia's nominal GDP is $2.05 trillion, whereas the US economy is the greatest in the world with a $28 trillion GDP. [1]

Service: Currently, the service sector employs the greatest number of people in the nation - more than 67% of the workforce - and accounts for more than 56% of the GDP (67.8% in 2022). [2] When we talk about the service industry, it includes trade, culture and entertainment, construction, and hotel and catering services. It is frequently noted that the crisis that followed the collapse of the Soviet Union allowed services to grow faster while also destroying manufacturing and agriculture.

Industry: Over the last ten years, the industry sector's share of Russia's GDP has stayed relatively constant, hovering about 30% (26,6% in 2022). [2] For comparison, industry in the United States only contributes around 18% of the country's GDP. Mining, manufacturing, building, gas, water, and electricity are all considered forms of industry. Among the many natural resources found in Russia are reserves of tungsten, iron, diamonds, gold, platinum, tin, copper, titanium, and natural gas and oil.

Oil and Gas sector: The most significant source of funding for the Kremlin is the oil and gas sector, which has generated between 30% and 50% of all federal budget income during the last ten years. On average, the Russian oil and gas industry accounts for 20% of the nation's GDP, though there are significant swings because of the cyclicality of world prices and, more recently, trade restrictions put in place by the West because of the conflict in Ukraine and Russia's attempts to reroute its oil and gas exports to other markets. [2]

https://caspianpost.com/en/post/russian-economy-at-a-crossroads

https://www.reuters.com/markets/rates-bonds/russian-industry-warns-central-banks-high-rates-hurt-crucial-new-investment-2024-10-23/

https://www.cnbc.com/2022/03/04/treasury-department-assures-wall-street-it-can-still-trade-russian-oil.html

Sector Analysis

Due to a more optimistic expectation for prices, Russia's economics ministry increased its 2024 projections for export sales of gas and oil by $17.4 billion from the previous estimate of $239.7 billion. [3] The better prospects for Russia's oil and gas industry surely highlight how the West has found it difficult to impose long-term harm on Russia's economy through the imposition of extraordinary sanctions over Moscow's war with Ukraine, such as import limits and oil price limitations.

According to the report, Russian crude oil exports are expected to increase from 238.3 million metric tonnes in 2023 to 239.9 million metric tonnes (4,8 million barrels per day) this year. Additionally, the ministry projects that the average price of Russian oil supplied for export would increase by $5 this year to $70 per barrel, up from an April projection [3]. Additionally, this is higher than the $60 per barrel price ceiling set by the West and higher than $64.5 in 2023.

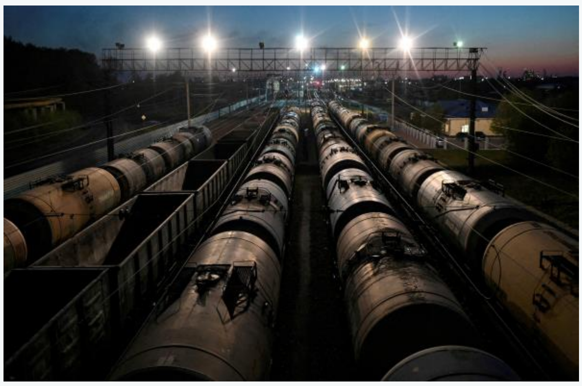
In addition, since it invaded Ukraine, Russia has been able to shift a large portion of its business away from Europe and increase trade with China and India. Regarding India, since then, Russia became one of its main trading partners, which we will discuss in more depth later on in the research paper.

These changes in trade partners resulted in increased profits for Russia. This year's almost $240 billion in oil and gas export revenue would be $13 billion more than in 2023. The estimate was also increased for 2025, going from $226.2 billion to $236.5 billion. [3]

In September, Vladimir Putin declared that without Russia's gas and oil, the world economy would collapse. He stated that Moscow intended to continue supplying gas to the European Union through Ukraine, but that Russia could not compel Kyiv to extend the transit arrangement, which expires at the end of this year, while addressing a business summit in Russia's Far East. The ministry lowered plans for both oil production and the total amount of energy exports, although Russia still expects gas output to rise annually until 2030, the end of current projections. In an attempt to stabilise the unpredictable market, Russia is taking part in initiatives by the Organisation of the Petroleum Exporting Countries (OPEC) and its partners to reduce oil production. [4]

https://www.wsj.com/articles/russia-ready-to-consider-adjusting-parameters-of-oil-output-deal-1499426516

https://www.oilandgasmiddleeast.com/business/insights/china-saudi-russian



https://www.reuters.com/business/energy/who-is-still-buying-russian-crude-oil-2022-03-21/

Sector Analysis: Agriculture and Food Production

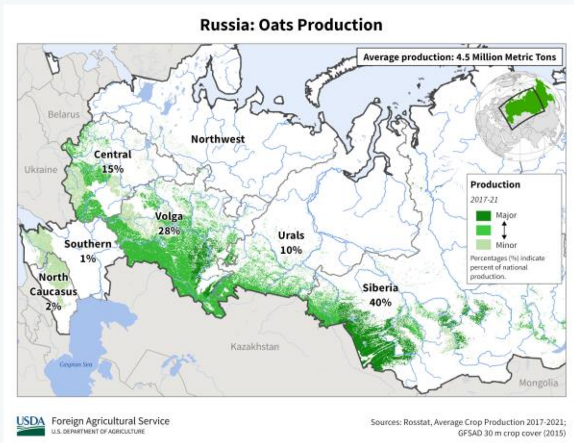
Agriculture is difficult and restricted to a few small sections of the country due to harsh weather and difficult topographical circumstances. This is among the primary causes of the agriculture sector's negligible contribution to the Russian economy. In 2022, the agricultural sector made up about 5.6% of GDP. Wheat is a key export crop, and agricultural output, particularly in the grain sector, supports both local demands and a sizable export market.

In order to feed the world's population, fertiliser is an essential agricultural input, and Russia is one of the biggest suppliers of this mineral kind worldwide. The Russian Federal State Statistics Service reported that Russia was the world's greatest exporter of fertilisers in 2022, with $18.7 billion in exports. [5] The United States ($1.95 billion), China ($910 million), Indonesia ($699 million), Brazil ($5.31 billion), and India ($2.73 billion) are the top destinations for Russian fertilisers. In 2021 and 2022, exports to India increased by more than 6 times.

For Europe, it is also a big deal. In August, Russia's exports of mineral fertilisers to the EU reached 3,3 million tonnes, up 43% year over year. Exports rose 32% to 1.1 billion euros ($1.21 billion). On top of that, it is also relevant to mention that Russia continues to be a significant supplier of unbanned fertilisers in Europe, despite the ongoing Ukraine war. In Europe, the top consumers of Russia's fertilisers are Poland (857,000 tonnes), France (380,000 tonnes) and Germany (375,000 tonnes). Poland increased imports by 2.7 times annually, France raised imports by 18%, while Germany cut purchases by 17%. [6]

As gas costs for ammonia (raw material for nitrogen fertilisers and power plants) have skyrocketed, the cost of fertiliser production in the EU, particularly for nitrogen fertilisers, has increased significantly in 2022. Major European producers like Grupa Azoty and ANWIL in Poland, as well as Achema in Lithuania, have been compelled to stop production.

https://www.themoscowtimes.com/2021/02/12/russias-agricultural-sector-boosts-output-despite-pandemic-a72921



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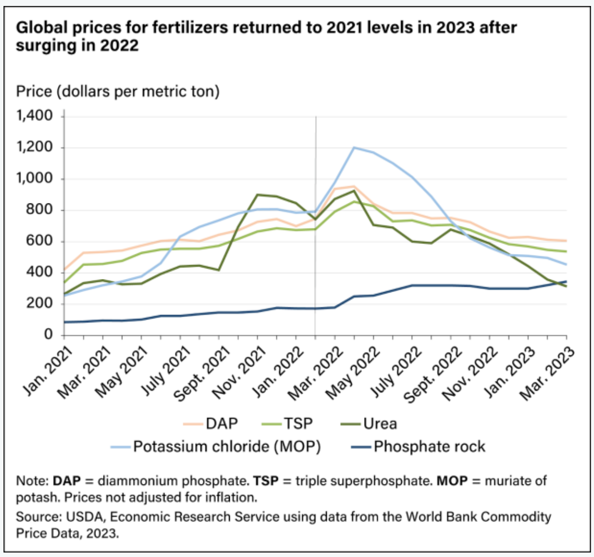


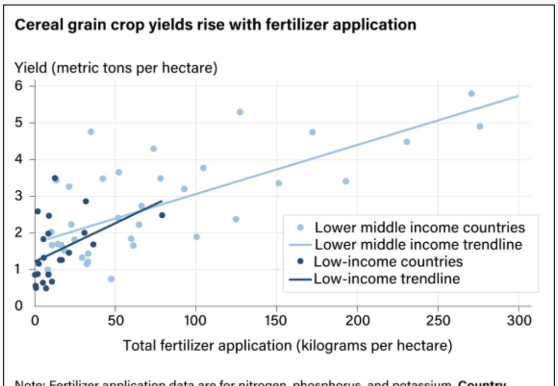
https://www.ers.usda.gov/data-products/chartgallery/gallery/chart-detail/?chartId=107374

Sector Analysis: Agriculture and Food Production

Fertiliser export prices were back to their pre-invasion levels by March 2023. In comparison to the April 2022 peaks, MOP and urea prices fell 62% and 66%, respectively, to return to 2021 levels. In mid-2022, urea prices varied somewhat, but MOP prices decreased steadily. Additionally, DAP and TSP prices decreased by around 36% from April 2022. On the other hand, the cost of phosphate rock kept rising. [7]

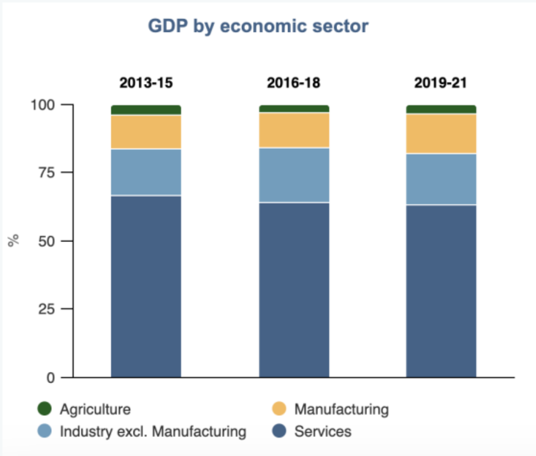
All of those changes regarding fertilisers have had severe consequences on food prices, which increased drastically at that time. In fact, farmers modified their production methods in reaction to those fertiliser costs increases. Some cut back on fertiliser use completely, which led to lower yields and higher commodity prices for Europeans consumers. Based on information from the UN Food and Agriculture Organisation, the graphic illustrates the connection between fertiliser use and crop yields. Fertilised acres yield more cereals on average. Less fertiliser is typically used by farmers in low- and lower-middle-income nations, which could further diminish crop yields. [8]

We also saw that Russia is also a big importer of food and agriculture, even if it exports a lot. Because it has had a strong economic development, particularly between 2000 and 2008, income growth during this boom period increased consumer demand for food, which was satisfied by imports. However, Russia's proportion of food imports was drastically reduced in 2014 when it prohibited the import of specific food categories, such as dairy, meat, and vegetables, from a number of nations, notably the United States and the European Union, in response to food embargoes imposed by the West. [9]



Note: Fertilizer application data are for nitrogen, phosphorus, and potassium. **Country income classification** based on World Bank classifications.
Source: USDA, Economic Research Service using data from the United Nations Food and Agriculture Organization for 2020 and World Bank Income Classifications for 2022.

https://www.ers.usda.gov/data-products/chart-gallery/gallery/chart-detail/?chartId=107376



https://www.focus-economics.com/countries/russia/

State Capitalism

State capitalism is defined by 3 factors: a system in which the majority of businesses are privately held and function under market circumstances; significant state ownership in businesses; and direct government participation in businesses. These are all met in Russia. ⅔ of the Russian stock market's market capitalisation is owned by the state. However, that ownership is primarily restricted to 5 businesses: media, banks, transportation, defence industries, and energy (oil, gas, and electricity).

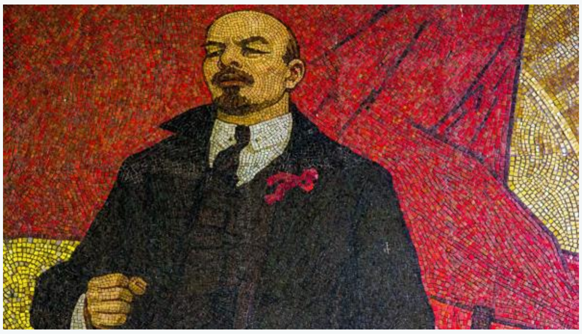
The majority of other economic sectors in Russia, such as consumer products, non-defence industry, agriculture, insurance, and services, have minimal state control. According to the expert interviewed, those state-owned enterprises (SOEs) are on the stock exchange by turning into Public Limited Companies and then saying that for example, 20% of those shares are traded on the market (ex: Gazprom, a Russian majority state-owned multinational energy corporation).

Even though they are mostly owned by the state, a minority stake is public. Indeed, because of this arrangement, the Russian stock exchange can function as a hybrid model, with privately held businesses driving activity in consumer goods, technology, and services and SOEs controlling the market in vital industries like banking and energy. The exchange provides the possibility for private investment, allowing minority shareholders to participate in SOEs. Furthermore, golden shares give the state a veto over important decisions, allowing it to maintain control over a few significant privatised businesses. To this day, about 4,100 businesses with some level of state ownership made up 39% of all jobs in 2007 (compared to nearly 80% in 1990). In 2007, SOEs held 37% of the utilities industry, 47% of the oil and gas industry, and 64% of the banking industry. [10]

Within Russia, SOEs have certain advantages. Unlike other businesses, they have access to low-cost loans (from state-run banking institutions). For their debts and other operations, they also benefit from an implicit state guarantee. Most significantly, they serve as a tool for rent extraction and political control in Putin's vertical power structure by enhancing supporters and offsets any competitors.

https://www.ft.com/content/d304a182-997d-4dae-98a1-aa7c691526db

https://communist.red/against-state-capitalism/



https://www.wspus.org/russia-lenin-and-state-capitalism/

State Capitalism

The entire system has only been made viable by a protracted boom in commodities that maintains high prices for natural resources and gives the government the means to carry out its state capitalist policy. Putin actually supports privatisation rather than socialism, therefore it is an ideologically neutral approach. The real government policy, on the other hand, is concentrated on controlling a few industries and businesses in order to increase, preserve, and consolidate political and economic power for the governing elites.

The Standard and Poor's index's average price-earnings ratio, which is calculated by dividing the share price by net profits per share, is typically 13. The most politicised state companies, Gazprom and Transneft, have valuations of 2.9 and 1.8, respectively, whereas the average for Russian state corporations is currently 5.7. [11] This data is from 2012 (used to not have the bias of the 2014 and 2022 conflicts) but we can examine that the Russian stock market has a low valuation as a whole, which is caused by these low valuations as well as the size of the companies involved.

Despite their low valuations, because they are not subject to competition, Russian state businesses are able to prosper in their own way. The transportation and defence industries are monopolies. Due to their access to inexpensive finance and a state guarantee, state banks are able to grow at the expense of more effective private banks.

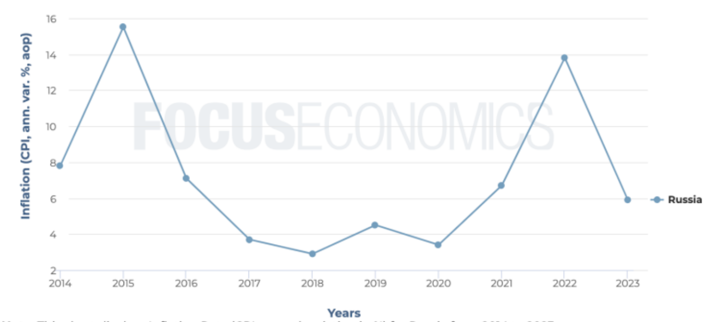
https://socialistworker.co.uk/features/state-capitalism-in-russia-a-theory-that-has-stood-the-test-of-facts/

https://www.salon.com/2022/03/01/bewildered-conservatives-call-putin-a-soviet-dictator-runs-a-communist-country/

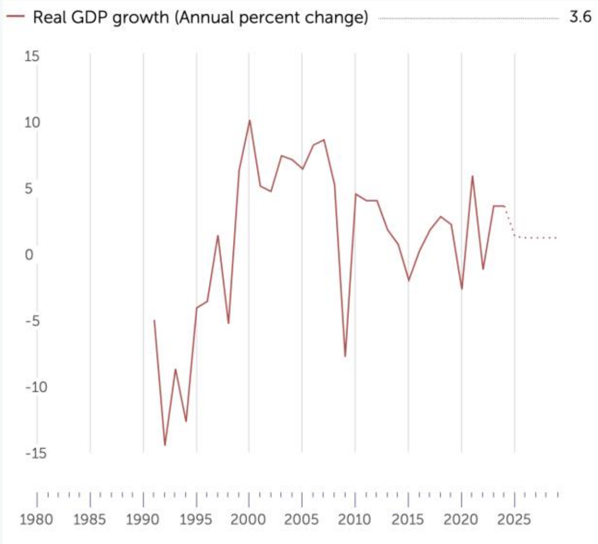
Economic Trends and Challenges

The International Monetary Fund (IMF) raised its 2024 growth prediction for Russia on October 22nd with rising government spending on the conflict, stimulating the country's economy. The IMF's most recent forecast is that it now anticipates the Russian economy to grow by 3.6% in 2024, up from its earlier prediction of 3.2%. [12] However, it also lowered its growth forecast for the next year from 1.5% to 1.3% in light of growing economic issues. In our interview with Mr. Kolyandr, he confirmed these predictions, stating that we can expect for the next several years Russia to grow at a very low rate anywhere between 1.8%, and at least below 2%, with relatively high inflation.

The Central Bank of the Russian Federation also has stated that the economy has been "overheating" for months and has cautioned on numerous occasions about the risks associated with the government's military expenditures. Moscow is also facing severe labour shortages and high inflation, which reached 8.6% in September. In an effort to curb inflation, the Russian Central Bank has raised interest rates to 21% this month. Meanwhile, Russia's Finance Ministry suggested increasing military spending by over 30% to about $145 billion next year, with defence and security spending together expected to make up about 40% of total state spending. [13] In recent years, there have been noticeable swings in Russia's economic trajectory. The economy showed resilience in the face of external challenges like geopolitical tensions and sanctions, as seen by its 3.6% growth in 2023 after falling by 2.1% in 2022. With another 3.6% growth forecast for 2024, this momentum is predicted to continue, but the rate is expected to drastically fall in 2025 to 1.3% or even 1.2% in the future. [14] The slowdown is caused by a faltering manufacturing sector as well as a decline in output in the raw material extraction industry, which has been going on for some months despite lowering export prices. The only industries where growth is still discernible are those associated with the military. Growth is either non-existent or, at most, weak in every other area of the economy.



Note: This chart displays Inflation Rate (CPI, annual variation in %) for Russia from 2014 to 2023.
Source: Macrobond.



https://www.imf.org/en/Countries/RUS

https://economymiddleeast.com/news/russian-central-bank-maintains-16-percent-interest-rate-amid-persistent-inflationary-pressure/

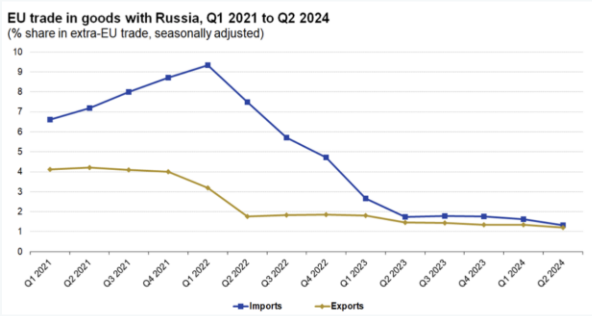
Economic Trends and Challenges

Inflation in Russia was high between 2014 and 2022, frequently surpassing 5%. Geopolitical tensions, economic sanctions, currency instability, and changes in the price of commodities globally all had a major impact on the nation's inflation. Although the Russian government and central bank took a number of steps to curb inflation, outside forces and internal economic difficulties kept driving up prices.

In the 10 years leading up to 2022, Russia's consumer price inflation averaged 7.2%, which was lower than the 7.7% average for Eastern Europe. The average for 2022 was 13.8% , but it decreased again to 5.9% in 2023, showing a good recovery. Nonetheless, in 2024, consumer prices are projected to increase by 7.9%, before falling again to 5.9% or even 4% in the far future. [15]

Today, there are high interest rates of 19%, (in comparison, the US and the UK are at 4.75%). But how can the inflation be at an average of 7.2% when the interest rates are at 19%? It is because government spending goes against the monetary policy, as Moscow is always massively boosting its military sector. This means that Russia is “depreciating” its inflation: its inflation is actually more than 10%. Because Russia has diverted all the spending to war (when creating tanks, weapons…), it is part of the GDP so ironically, Russia is actually increasing its GDP. As we previously saw, its GDP is positive. However, positive GDP growth does not always indicate strong economic health in the complicated picture of the Russian economy.

Even while the GDP has shown resilience, artificial measures like capital controls, which temporarily stabilised the ruble following its earlier collapse, have a significant impact on it. However, these actions don't deal with the economy's more fundamental structural problems. The Central Bank boosted interest rates to 21% in an attempt to slow price increases, but inflation is still a major worry. Furthermore, the economy is far from thriving even though it has managed to avert complete collapse. Although the increase in military spending has significantly increased the economy's liquidity, it has also increased inflationary pressures. Though it may generate short-term activity, the increased money flow exposes underlying weaknesses rather than true economic strength. [16]



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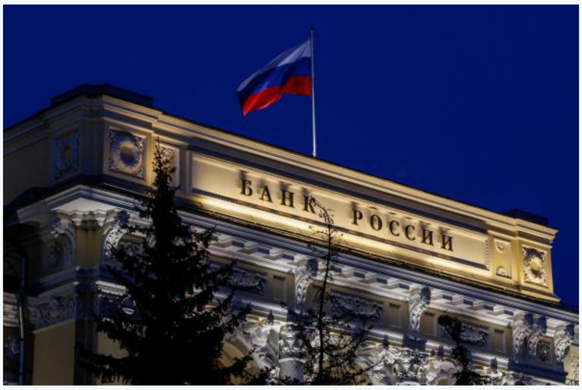


https://www.reuters.com/markets/europe/russian-cenbank-downplays-role-dollar-euro-home-globally-2022-05-31/

https://www.cnbc.com/2022/04/29/russia-cuts-key-interest-rate-to-14percent-says-inflation-could-hit-23percent-this-year.html

Economic Trends and Challenges

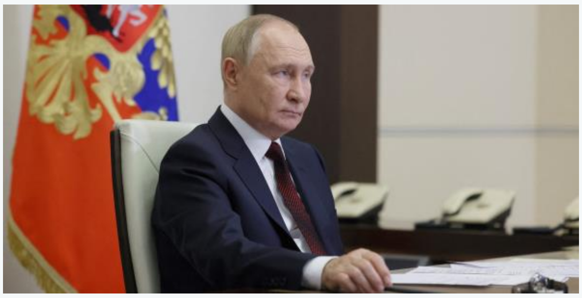
Economists are starting to talk about the risk of stagflation, which is a combination of slow growth, high unemployment, and rising prices, more and more as the Russian economy continues to show indications of slowing growth. Since the war in Ukraine cannot be officially blamed, the Central Bank points to "external factors," while government-affiliated economists and business executives accuse the Central Bank of setting record-high interest rates.

Compared to the previous quarter, imports from and exports to Russia fell by 16% and 9,5%, respectively, in the second quarter of 2024. The value of EU imports from Russia decreased by 87% between the first quarter of 2022 and the second quarter of 2024. In the second quarter of 2024, Russia's share of petroleum oil imports outside the EU decreased from 21% in the second quarter of 2022 to 1%. [17]

Russia is heavily reliant on energy and fuel production. The mining and production of energy resources, as well as the processing, distribution, and consumption of all forms of energy, make up the nation's so-called fuel and energy complex. These businesses sustain several economic sectors, and Russia's primary exports are their goods.

Furthermore, Russia's economy is significantly shaped by its state-capitalist system, with state-owned firms controlling ⅔ of the stock market in vital industries including banking, defence, and energy. This hybrid model, which frequently uses tools like golden shares, permits private investment while retaining a high degree of government control. Nevertheless, this dependence on military spending and commodities, which propels GDP growth in the short term, raises inflationary pressures and conceals more serious weaknesses.

To create a more balanced economy that is less vulnerable to changes in commodity prices, Russia will probably need to diversify even further. It may be possible to attain more sustainable long-term growth by concentrating on its industrial and service industries, tackling systemic issues and lowering an excessive dependence on sectors controlled by the state.



https://www.businessinsider.com/russia-economy-outlook-stagflation-recession-inflation-gdp-growth-ukraine-war-2024-11

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Russia’s War Financing Scheme

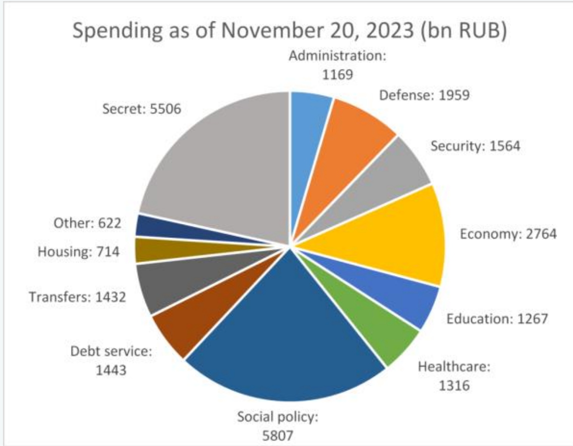
Analysis of the Commodity market: Oil and Gas Production

Russia has announced that it will increase its ‘defence’ budget by a record 25% to 13.5 trillion rubles ($140 billion) in 2025, accounting for about 40% of the state budget. [1] Such massive figures make us wonder, with all the sanctions being imposed by different countries to isolate Russia, how does the country manage to finance the war. Firstly, we will analyse how the recent surge in oil and gas prices has benefited Russia, then discuss the formation of new partnerships, particularly with China and India, and finally address the use of parallel imports, including the smuggling of Russian oil and gas into the EU market through third countries.

The Russia-Ukraine war has severely impacted the global energy and commodity markets, primarily by driving up crude oil and gas prices. Price increases can be attributed to fears of supply disruptions caused by the war, along with sanctions imposed on Russian energy exports, as previously discussed. Surprisingly, despite the negative impact of rising crude oil prices on businesses, households, and countries worldwide, Russia has benefited significantly. The massive increase in crude oil prices over the past year has outweighed the decline in export volumes due to sanctions, enabling Russia to increase its revenues from oil exports and finance the war.

Oil and gas are known for their inelastic nature due to the low responsiveness of demand to price changes in the short term. This is because oil plays a critical role as a raw material in the production of nearly all goods. As a result, oil prices are highly volatile, and extreme events like the Russia-Ukraine conflict lead to sharp price fluctuations.

Since the conflict began in February 2022 many European countries have struggled with skyrocketing energy prices. This is because most European countries had previously relied heavily on oil and gas imports from Russia, but the war and sanctions imposed by different countries on Russian imports severely disrupted supply chains, leading to sharp increases in the cost of this limited but essential resource and putting immense pressure on households and businesses.



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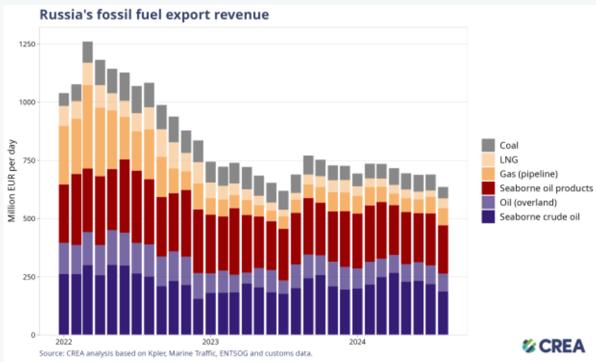
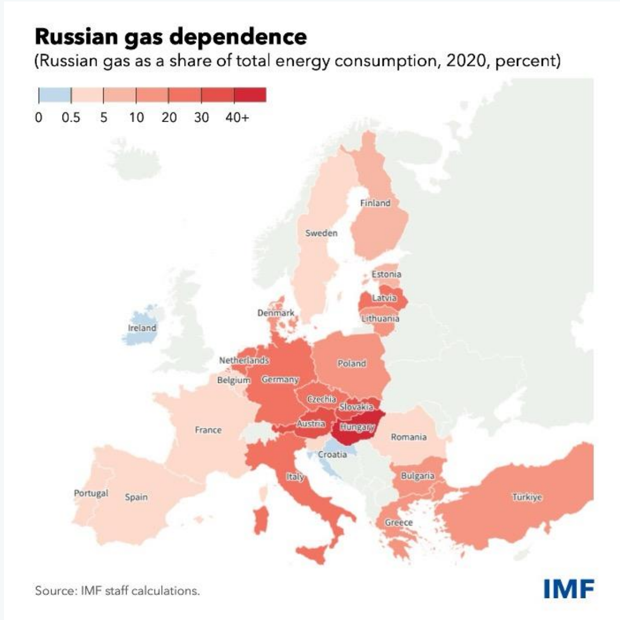


https://energyandcleanair.org/august-2024-monthly-analysis-of-russian-fossil-fuel-exports-and-sanctions/

The map on the right depicts the dependence of European countries on Russian gas. Most countries heavily rely on Russian gas for energy consumption, thus further explaining the increase in oil prices.

A study published in *Nature* examined the period from October 1, 2021, to August 25, 2022, and found that the war and its related events caused a significant spike in oil prices. West Texas Intermediate (WTI) crude oil prices rose by $37.14, a 52.33% increase, while Brent crude oil prices surged by $41.49, a 56.33% rise. The study concluded that the Russia-Ukraine war accounted for 70.72% and 73.62% of the fluctuations in WTI and Brent crude oil prices, respectively. After Saudi Arabia, Russia is the world's second-largest crude oil exporter, accounting accounting for 9.14% of global exports in 2022. [2] As a result, many countries around the world heavily rely on Russian crude oil as a critical raw material to sustain their economies. Despite sanctions restricting exports, Russia has managed to benefit significantly from the surge in oil prices. The elevated prices have provided Russia with substantial income, offsetting the reduction in export volumes and helping finance its war efforts. In 2022, Russia's budget revenues from oil and gas increased by 28%, amounting to an additional RUB 2,500 billion (approximately $36.7 billion). [3] Other oil-producing countries, including the United States and some in the Middle East, have also experienced higher revenues as a result of the price surge.

Finally, more recent developments are putting pressure on Russian energy companies due to sanctions and shifting alliances. For instance, Lukoil, a major Russian state energy group, plans to sell its largest asset in the Balkans, a refinery in Bulgaria, to a Qatari-British consortium. This move highlights Russia's weakening influence over energy supplies in Southeast Europe. The selling of this state energy group will provide huge profits for the Russian state, enabling them to further finance the war, and at the same time is a strategic move that will relieve the pressure on the ongoing sanctions that are being imposed that limit Russia's ability and capacity to sell and export oil at very high prices. Overall, Russia has financed its war largely through the increase in oil prices that the conflict itself has driven. Although numerous sanctions imposed by various countries have restricted Russian imports, the surge in oil prices has outweighed these effects. As a result, despite reduced export volumes, Russia's revenue has still increased, enabling the government to continue financing the war.



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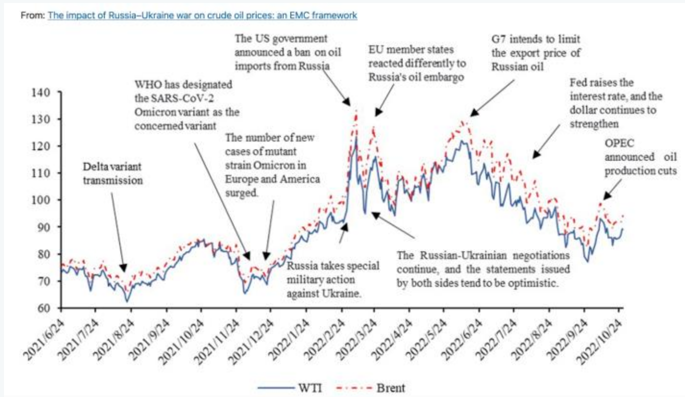

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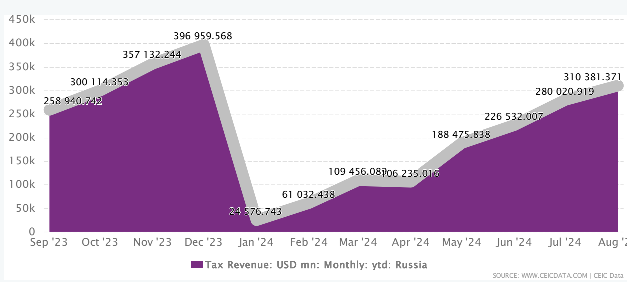


https://www.ceicdata.com/en/indicator/russia/tax-revenue

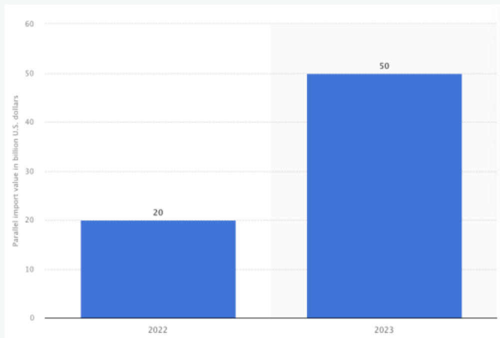
Parallel imports

Since the Russia-Ukraine conflict, we saw that an immense amount of global economic sanctions have been imposed on Russia, aiming to diminish the country's international importance so that it feels pressured to de-escalate war efforts. However, on top of these sanctions, some western private companies made decisions that also impacted the economic health of Russia. In fact, to protest against the war but also to avoid any possible sanctions they could receive by making profits in the Russian market (which Russia could use to finance the war), they suspended their activities partially or completely. The main card networks (Mastercard, Visa, and American Express) are the most significant businesses that left the country. All said that they will no longer permit transactions on their networks with merchants outside of Russia using payment cards issued by Russia. Additionally, all transfers between the EU and Russia were stopped when major Russian banks were disconnected from SWIFT. [1]

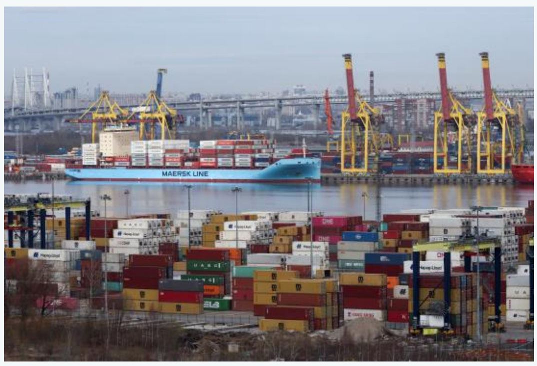
To counter the exits of these companies, we saw an increasing pattern of Russian threat actors engaging in carding (illegal use of stolen credit card information), mule fraud (intermediaries used to transfer/launder money or goods obtained illegally), illegal resale, and brand abuse. The increase in activities was only intensified by Russia's decision to legalise the so-called "parallel imports", which are goods imported by unlicensed distributors for sale at less than the manufacturer's official retail price. As imports fell, Russia started a parallel import scheme in May 2022 that included everything from apparel to electronics and auto parts. The list is created in accordance with the foreign trade commodity codes of the Eurasian Economic Union (EAEU), but it also identifies specific goods and materials from other countries that are permitted to be imported into Russia in parallel. In fact, Russia released a list of Western products that are eligible for importation under the parallel import system. Along with consumer products like electronics and home appliances, apparel, footwear, and cosmetics, general Electric gas turbines have been approved for parallel importation by the Russian Ministry of Industry and Trade. [1] We will focus on how Russian oil and gas is smuggled in the EU market through third world countries.

Despite the EU's strict sanctions on Russian oil and gas imports, a growing trend of parallel imports has emerged. Russian energy products are indirectly reintroduced into the European market through third countries such as Turkey, China, and India, to repackage or relabel Russian-origin energy products, allowing them to bypass sanctions and restrictions. For example, last year Moscow benefited an additional €1 billion from a different EU sanctions breach in Bulgaria. [1]

https://www.managingip.com/article/2a5d15ejam5bo2me9vlkw/russia-allows-parallel-import-of-patented-and-trademarked-goods



https://www.statista.com/statistics/1347702/russia-parallel-imports/



https://www.reuters.com/business/russia-publishes-list-parallel-imports-goods-2022-05-06/

Parallel imports: India's role

The two nations' ties go back already to April 1947 when India became independent. In fact, since then, successive events showed the positive evolution of their relationship, such as the support India received from Russia during the Cold war. Particularly during the 1971 conflict between India and Pakistan, when the US and China sided with Pakistan, the Soviet Union backed India. In addition, in that year, the two nations signed a treaty of friendship and cooperation. From that point on, their link has persisted. Both countries signed a strategic partnership in 2000, annual summits have been conducted, since 2021 they have been having combined talks with their foreign and military ministers, and many more collaborations... More recently, Russia has been increasingly becoming an important strategic ally of India. Practically speaking, India gained a lot from having access to cheap Russian crude oil, which grew from less than 2% of India's total imports (before the invasion of Ukraine) to more than 40% in June 2024. [3] Nonetheless, their cooperation is not limited to oil. Indeed, in the nuclear field, where there is a solid historical basis, a deal to construct 6 civil nuclear power facilities in the Indian state of Tamil Nadu was updated in February 2024.

For those reasons, since the start of the war in Ukraine, India has quickly become the second-largest importer of Russian crude oil. Less than 1% of India's total oil imports were from Russia prior to the conflict, but this has now increased to around 40%. [3] Since the EU and G7 countries placed a price ceiling and embargo on Russian crude in December 2022, a loophole has let non-sanctioning countries to purchase Russian oil, process it, and then re-export the refined products back to the EU at market pricing. India has taken advantage of this circumstance, as seen by the 58% increase in gasoline shipments to Europe during the first 3 quarters of 2024. [3]

India is now the 2nd largest customer of Russian petroleum after China, with oil imports from Russia totalling around EUR 2 billion in October 2024. [3] India is at the centre of a complicated geopolitical discussion, and its increasing involvement in this global energy trade highlights its strategic energy objectives. Being the 3rd largest importer of oil in the world, India's reliance on Russian crude reflects the changing energy dynamics in the wake of the conflict in Ukraine and offers both economic advantages and geopolitical challenges.

https://www.npr.org/2023/02/20/1156478956/russia-india-relations-oil-modi-putin

https://carnegieendowment.org/research/2022/09/russia-and-india-a-new-chapter?lang=en&center=china

https://theprint.in/defence/india-russia-working-on-new-payment-system-for-defence-deals-amid-more-sanctions/1094178/

Parallel imports: Turkey and China's Involvement

Another important actor in this dynamic is Turkey. According to investigations, Turkish authorities are rebranding Russian oil before it is shipped to the European Union. Investigations into schemes where Russian fuel is probably rebranded in Turkey to get over EU sanctions have been started by the European Anti-Fraud Office (OLAF). Under the pretence of Turkish-origin goods, this approach permits Russian oil to reach the European market. In the 12 months following the EU's February 2023 sanctions on Russian oil imports, the loophole brought in up to €3 billion for Moscow from just 3 Turkish ports. [4] The tactic demonstrates the innovative ways Russia gets around EU sanctions and defends its fossil fuel trade, which provides over half of the Kremlin's income.

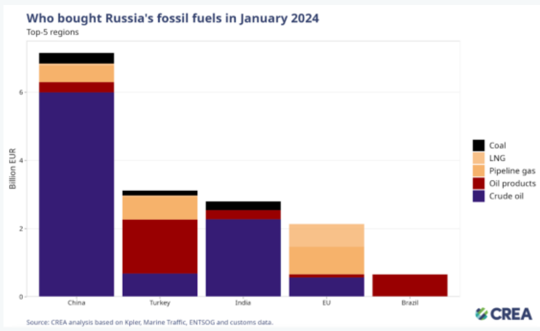
China has significantly increased its imports of Russian gas and oil since the EU imposed sanctions on Russian energy exports, helping China fuel its economy which is extremely energy hungry. By giving Russia access to a different market, this surge has minimised the effect of Western sanctions. For example, compared to the same period in 2022, China's imports of Russian crude oil increased by 23% in the first half of 2023.

China turns Russian crude oil imports into a variety of petroleum products, including petrol and diesel. Following refinement, these goods are shipped to markets throughout the world, including the EU. By doing this, China essentially serves as a middleman, enabling energy of Russian provenance to infiltrate the European market. A considerable amount of China's 15% growth in EU exports of refined petroleum products in 2023 came from Russian crude oil. [5]

By establishing itself as a vital energy intermediary, China's plan not only secures discounted energy supplies but also enhances its geopolitical power. We can see here that with 33% (EUR 7,1 billion) of all imports in January, China was the biggest buyer of Russian fossil fuels. India came in third with an 18% (EUR 2,8 billion) import share, while Turkey came in second with 20% (EUR 3,1 billion). Brazil and the EU each made 4% (EUR 0,7 billion) and 13% (EUR 2,1 billion) of Russia's fossil fuel exports. [5] However, despite Brazil being a significant trading partner of Russia, according to our interviewee, Russia and Brazil continue to battle for oil distribution in Latin America. Both countries compete to replace Venezuelan oil in the region and supply comparable goods. This competitiveness has caused some tensions despite their good trading relations. Nevertheless, the effect of Western sanctions on Russia has allowed Brazil to gain greater influence and control in that region.

https://www.iir.cz/en/how-turkiye-s-balancing-strategy-between-russia-and-the-west-matters-1

https://www.newsweek.com/russia-china-relations-vladimir-putin-xi-jinping-ukraine-1718376



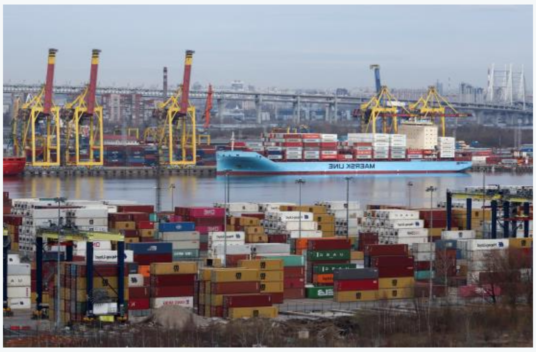
https://energyandcleanair.org/january-2024-monthly-analysis-of-russian-fossil-fuel-exports-and-sanctions/

Parallel imports: Conclusion

By undermining the EU's sanction framework, these parallel import activities allow Russia to preserve sources of income that are vital to its economy. Despite prohibitions, Russia has been able to continue its energy exports to Europe indirectly by re-exporting its oil through nations like Turkey, China and India. The expert we interviewed pointed out that even if sanctions on Russia were to be lifted, it would be very unlikely that parallel imports would disappear since many people and companies are now financially dependent on them, which has led to resistance to change. Another point was that more recently, payment issues were brought on by the U.S.'s harsh enforcement of secondary sanctions on financial institutions to make it harder for countries to procure themselves Russia’s oil. He specified that payments for imports between Russia and nations like China or Turkey, which used to take days to process, now take weeks and occasionally fail. Finally, we also learned that the EU intends to impose more strict "end-user certification" standards at the start of next year. Because exporters will be held responsible if their products are discovered in Russia.

These regulations will put pressure on the exporters to check and do all the due diligence to ensure that their exports don’t end up in Russia.
As a consequence of both internal economic goals and international geopolitical constraints, the Russian government has a large role in guiding and managing the economy, a position that has grown considerably in recent years with the Ukraine war.

To maintain economic stability and further its strategic objectives, Russia has also implemented measures to promote vital industries including defence, oil, and gas, which helps them keep up output levels even when prices change or exports are restricted internationally



https://www.reuters.com/business/russia-publishes-list-parallel-imports-goods-2022-05-06/

https://www.themoscowtimes.com/2023/03/09/sanctions-loophole-closed-as-turkey-blocks-parallel-imports-to-russia-a80436

Subsidies and Support for Affected Industries

Russia's oil industry has adjusted to the new situation more than six months after the EU placed restrictions on Russian oil and petroleum product exports. The sector has avoided a decline in oil processing while reducing crude output by just 5% thanks to the discovery of new markets. Additionally, there has been a rise in the sales of petroleum products and oil.

The avoidance of severe output cuts, however, only amounts to a partial success. First off, the existing structure of Russian oil and petroleum product exports is unstable and heavily reliant on sales to China and India, which together make up as much as 80% of Russia's overall sales. Second, certain shipments have been discounted since the EU and G7 nations imposed a price restriction on Russian oil. Additionally, the sanctions have increased the cost of transporting crude. Russia can sell more oil as a result, but its budget income has also decreased. Thirdly, the Russian government has pushed through tax adjustments for this industry, but they have not increased budget revenues and have instead removed incentives for investment and given rise to more capital outflows from Russia. [1]

In recognition of the oil and gas industry's critical role in the economy, the Russian government has implemented certain subsidies (paid monthly) to maintain output and stabilise domestic markets such as the Damping Mechanism. Petromarket stated that "the government subsidies, in particular, the damping surcharge, paid when supplying motor gasoline and diesel fuel to the domestic market, has primarily contributed to the [rise in] net margins of oil refineries". We can therefore understand that it was introduced to stop companies from capitalising on high fuel export prices and defend the domestic market. Indeed, by providing refiners with compensation for delivering motor petrol and diesel fuel to the domestic market, this subsidy effectively protects them against changes in international prices. Each month, the pay fluctuates; for diesel, it ranges from 15 000 to 30 000 rubles per metric tonne ($30 to $60 per barrel), whereas for petrol, it is around $17 per barrel. [2]

However, because they only generate small quantities, they are rarely qualified for the petrol and diesel damping mechanism compensations. Therefore, even though payments have decreased since February 2022 because of the drop in crude prices, oil refiners can still profit from the refundable excise tax on crude oil. They receive financial aid from the Russian government's Refundable Excise Tax, which is intended to stabilise local output. However, data is limited about this topic since 2022 and Russia stopped publishing its data. [3]

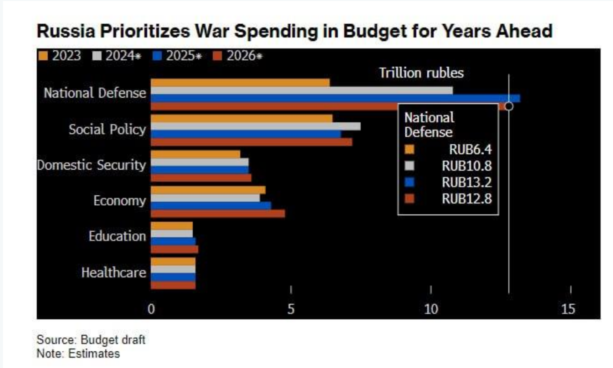
Policies Supporting War-Related Sectors

With the arrival of North Korean soldiers to the battlefield, Russia is showing no sign of stopping. Its Ministry of Finance even stated that "resources will be allocated and have already been allocated for equipping the armed forces with the necessary weapons and military equipment, paying military salaries, and supporting defence industry enterprises.".

Hence, that is why Russia has greatly expanded its defence expenditure in response to geopolitical pressures and to strengthen its military capabilities. For example, military technology firms and arms manufacturers are prioritised in state budgets, benefiting from contracts, subsidies, and tax incentives. Since the full-scale invasion in 2022, Russian defence expenditure on national security has been rising, and it is expected to hit more than 6,3% of GDP (more than $113 billion) in 2025, the highest level since the Cold War. [1] This implies that almost ⅓ rubles of the Russian budget will go towards assisting the military sector and the war effort. The existence of "unspecified" spending that is most likely related to the war effort and the growth in the production of civilian industrial goods (such as consumer electronics, agrochemicals, metalworking products, etc.) that support military operations exacerbate the increase in defence expenditures.

According to papers released in September, although last year's news was that Russia was aiming to cut defence spending by 21% in 2025, it is actually now leaning towards an increase of 25% from the 2024 level, rising up to 13,5 trillion rubles ($145 billion). Out of the 41,5 trillion roubles ($446 billion) budgeted for 2025, 32% will go towards defence. If we compare these indicators to 2022, the year the conflict in Ukraine began, we can see that there is a huge difference: 5,5 trillion rubles ($59 billion) were spent on military (around 7,5 times more, 656% more). [2]

In order to improve defence capabilities and encourage innovation, the Russian government has aggressively encouraged partnerships between the public and private sectors in war-related sectors. For example, to improve military technology, cybersecurity, and artificial intelligence, Rostec, a state-owned company and a significant participant in Russia's defence industry, launched the Artificial Intelligence Technologies Research Laboratory in the beginning of 2022. [3] This centre focuses on incorporating AI into large data, virtual reality, radio communication systems, and deep neural network machine learning. Another example is the well-known arms manufacturer Kalashnikov Concern, with whom NOVIKOM Bank has decided to deepen its collaboration in August 2024 [6], in the area of drone manufacturing development. Kalashnikov Concern stated in August 2023 that it planned to provide skilled drone engineers with all-encompassing assistance. [4] The strategic significance of combining financial and technological resources to enhance unmanned aerial vehicle (UAV) capabilities is highlighted by this decision.



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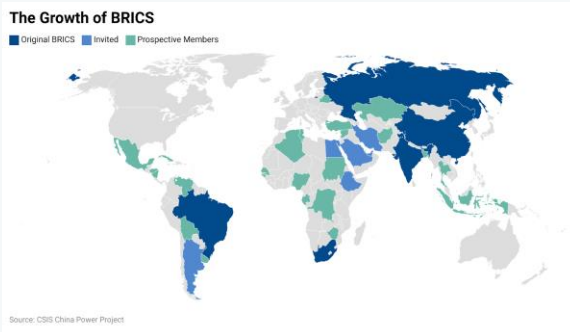
A New Reliable Partnership? : the BRICS

OPEC was not enough to open up new financing routes for Russia. Therefore, it is important to highlight the formation of the BRICS organization in 2009. This summit was formed by Brazil, China, India, and Russia and was born as an alternative to the G7. These countries mentioned that BRICS is “an association of leading emerging markets and developing countries, based on bonds of friendship, solidarity and shared interests”. With the incorporation of Argentina, Egypt, Iran, Ethiopia, Saudi Arabia, and the United Arab Emirates. The BRICS hold more than 40% of all the world’s oil production.[1]
As previously mentioned, India’s role and China’s participation have been crucial to Russia's ability to overcome sanctions and remain strong in the oil market.

However, apart from the effect of the BRICS in the oil industry, It should also be noted that BRICS countries are working to reduce their dependence on the US dollar in oil trades, which aligns with Russia’s goal of exceeding Western sanctions. However, the possibility of developing a new BRICS currency is seen as impossible by many economists. The financial analyst Alexander Kolyandr mentioned that this development of a BRICS currency would probably be a failure. On one hand, the three main countries that are part of BRICS are India, Russia, and China. These countries have high capital controls and non-convertible currency, which would make it very difficult for them to create a common currency to compete with the dollar. On the other hand, most of the countries of BRICS buy more from China than what China sells to them, therefore the currency would be highly linked to China’s currency. This would result in the currency being very unstable and thus would not provide reliable competition against the U.S. dollar. Moreover, the lack of confidence in the ruble or the yuan exacerbates even more this phenomenon. As Alexander Kolyandr clearly explained, “Who wants to keep their savings in Rubles?”.

It should also be added that Russia has developed a new international transaction system which is a response to the sanction regarding the exclusion of the nation from the SWIFT system. This system implemented in Russia is known as the SPFS and is a reliable channel for exchanging electronic messages on financial transactions. [2]



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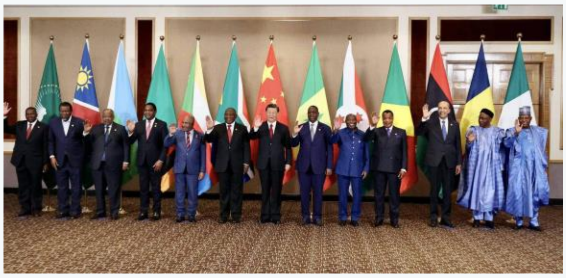

https://www.revueconflits.com/determines-les-brics-sont-sur-une-route-longue-et-sinueuse-vers-un-monde-multipolaire1/

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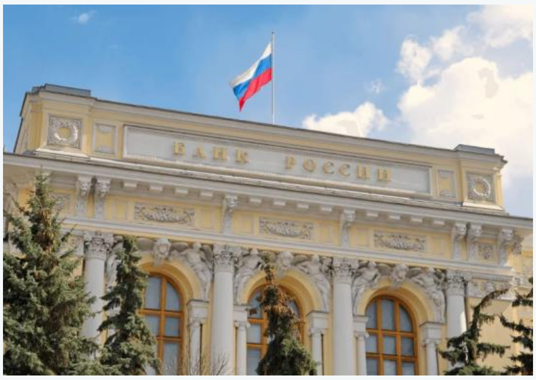
BRICS: BRICS is an intergovernmental organization comprising nine countries – Brazil, Russia, India, China, South Africa, Iran, Egypt, Ethiopia, and the United Arab Emirates..

A New Reliable Partnership? : the BRICS

This development is also an alternative to bypass Western-dominated financial institutions. One of the key points of this system developed by Russia is that it provides domestic and international connectivity… By Q3 of 2023, 550 organizations were connected to the SFPS, and 150 of these organizations were from foreign countries. These participants interact directly with Russia's Central bank, which helps the country to keep connected with foreign nations and improve the bank's operations. Another key point is its international expansion. Thanks to this system, Russia can extend its operations and make a presence beyond its domestic borders. Russia achieves this by pursuing agreements, primarily with countries that are also part of the BRICS. An example is the infrastructure that Russia is developing with Iran where they combine their financial messaging system SEPAM and SPFS. Another important agreement that must be taken into account is the one with China, as the SPFS and the CIPS (international transaction system of China) have been connected. [3]

Nevertheless, financial analyst Alexander Kolyandr, mentioned that Brazil, China, South Africa, and other countries from the BRICS, apart from Iran (which suffers from similar sanctions to Russia), are quite happy with the SWIFT system. Hence, there may be no incentives for them to adopt the new transaction system as it can result in sanctions from the EU or the US.

https://bfsi.economictimes.indiatimes.com/news/banking/how-the-swift-payment-system-ban-will-impact-russia/89888068



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A demographic Urgency

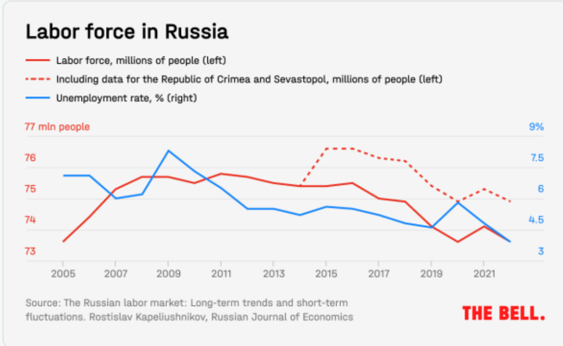
The war between Russia and Ukraine has not only caused economic and financial consequences but has also affected socio-economic aspects. Many of Russia's citizens do not see their nation as a safe or prosperous place to develop their lives or to raise families. Therefore, demographic issues have considerably increased, having a direct effect on the nation's economy.

With this in mind, it is worth noting the problems that Russia has related to the aging population and low birth rates. Since the fall of the Soviet Union in 1990, Russia has had demographic problems related to high age and low number of births. These challenges have increased with the outbreak of the war between Russia and Ukraine, not only because of the mobilisation of citizens to the battlefield but also because of the country's internal instability (emigration and reluctance to have children). As a result, the United Nations forecasts that by 2100, the Russian population will have decreased by 25 to 50%. [1]

Moreover, the Rosstat (Russian Federal States Statistics Service) has mentioned that Russia, ,in the first half of 2024, has registered the lowest number of births (599,600) in the last 25 years, showcasing a very low fertility rate of 1.826 per woman. [2]

The Kremlin Dmitry Peskov has defined the situation as "catastrophic for the future of the nation" and mentioned that these internal issues have become one of the nation's priorities. Consequently, the Russian government has implemented measures to encourage childbearing through subsidies and economic benefits. However, many economists see this as a short-term solution that will not solve the situation in the long term. In the graph below it can be seen that since the annexation of crime, demography has considerably decreased in Russia.

It should also be added that military recruitment, emigration and the increase in demands of defence production have increased manpower shortages. Maxim Reshetnivok (Russian minister of economic development), stated in September 2023 that human labour has become the scarcest resource of the nation since the war started. [3]



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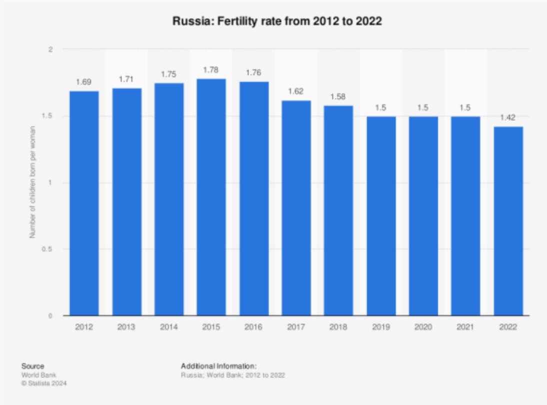

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https://www.themoscowtimes.com/2024/10/14/russia-to-raise-maternity-subsidies-in-2025-amid-population-crisis-a86676

Over time, a fertility rate below 2 without immigration or changes in fertility rates, the population size is likely to decrease.

A demographic Urgency

Regarding the defence sector, in February 2024 Vladimir Putin mentioned that 520 000 people have been employed in Russia's defence sector. Nevertheless, although H.E. Denis Manturov (Russia's first deputy prime minister) mentioned that wages in the defence sector have increased by 30% to 60%, he also mentioned that defence industry in Russia is short of about 16000 specialists. [4]

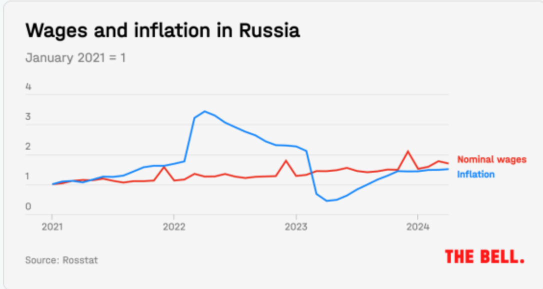
This shows a clear imbalance between supply and demand in this sector. The consequences of this could be very serious for Russia, since it could mean that its arms production ratio will not be sufficient to cover future war demands.

Regarding the whole Labor Market, manpower shortages have also increased since 2022. The Russian Academy of Sciences has mentioned that Russia currently faces a labour shortage of around 4.8 million of workers. [5] Moreover, it should be added that the growth of this phenomenon is exponential, which means that it may worsen significantly in the short term. These can have a significant effect in Russia's economy, as a shrinking workforce can hinder production and therefore economic growth.

-

Manpower shortage is also a challenge regarding military recruitment. Economists estimate that Russia has suffered around 600,000 casualties because of the war. [6]

Also, the Patriot military recruitments have caused political and social instability, resulting in internal crises. Therefore, Russia has had to resort to foreign help to send more military personnel to the front. North Korea has provided 100,000 men to Russia to go to the battlefield. Although this solves the problem of lack of men at the front, it is questionable whether it will be sustainable in the long term. [7]



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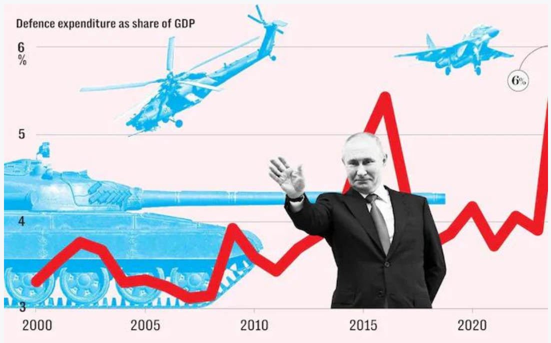
Conclusion

In conclusion, Russia’s economy, alongside the war in Ukraine, has had to face several challenges and is still handicapped by ongoing sanctions. But, Russia has succeeded in mitigating the effects of these sanctions. By finding new trade partners such as China and India, Russia replaced the EU as its first trade partner, showcasing its resilience over the West and reducing the effects of Western sanctions. Moreover, thanks to the state-capitalist nature of its economy, Russia supported most of its affected industries with significant subsidies to sustain its economy. Overall, Russia was able to protect the “weak” point of its economy: the oil and gas industry.

Consequently, Moscow benefited from a disrupted oil and gas market which led to a spike in the price of these commodities. Therefore, Russia realized record revenues from its fossil fuel exports from 2022 onward. A much-necessary inflow of capital as war costs a lot. As there are 3 main ways to raise capital to finance a war: printing money, borrowing, and taxation, Russia selected the third option. Indeed, Russia is facing constraints on raising debt due to high interest rates and sanctions. And printing money would weaken the ruble even more and exacerbate inflation. Hence, Moscow, unable to raise debt or print money implemented new tax policies to fund defense spending. These measures include taxing oil and gas exports but also increasing income taxes for high earners and raising corporate profit taxes from 20% to 25%, aiming to generate an additional 2.6 trillion rubles for the budget. The new main driver of its economy, the defense sector, very expensive and financed by the Kremlin, has created hundreds of thousands of jobs, boosting wages and reducing unemployment. It helped keep the economy growing but at a cost: inflation and labor shortages. The efforts of Russia’s central bank to tackle this inflationary pressure have still not proved to work and its demography issue is still unsolved.

Even though the risk of Stagflation is high, Russia is arguably in better shape than many EU countries. With approximately the same economic growth as Europe, Russia relies significantly less on debt than its neighbors.

Concerns over the solvency of EU countries are beginning to rise, for instance, in 2023 France’s Government Debt to GDP was at 110.60%. In contrast, Russia's government debt-to-GDP ratio was about 19.6% in 2022. Russia's current economic model has shown resilience and, for now, displays its strength over the West. Although the future is uncertain regarding Russia’s economic trajectory, Putin has made something clear: Russia needs more than Sanctions to be beaten to death.



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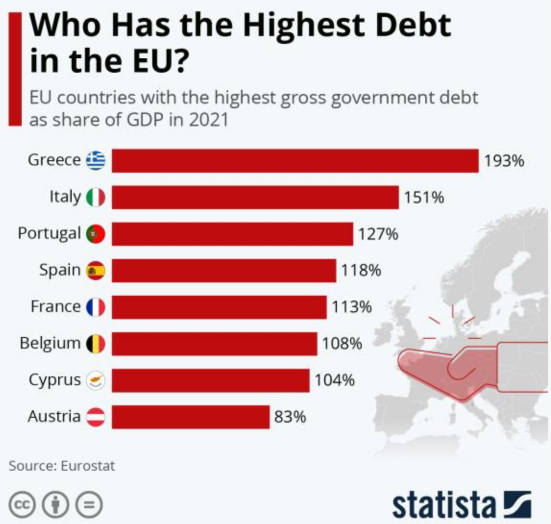

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