Russia's Economic Landscape:

Navigating Recession, Inflation, and Sanctions

Gubad Ibadoghlu, a senior policy analyst at the Economic Research Center

Abstract:
This article analyzes the current state of the Russian economy, which is characterized by a complex interplay of overheating, inflationary pressures, and the impact of international sanctions. Despite moderate GDP growth and low unemployment, the economy faces significant vulnerabilities, including rising inflation, declining investment activity, and a depreciating ruble. The Central Bank of Russia's policy of maintaining high interest rates, intended to stabilize the currency and control inflation, has inadvertently constrained economic growth and heightened uncertainty for businesses.

These challenges are further exacerbated by shifts in foreign trade dynamics, with declining exports and imports reducing the balance of payments surplus. Western-imposed sanctions continue to target Russia's energy sector, implementing measures such as oil price caps and restrictions on Gazprombank. While these sanctions aim to undermine the Russian economy, previous efforts at localization have partially mitigated their impact, allowing the country to sustain energy revenue streams.

Nevertheless, the prioritization of military expenditures, surpassing budgetary allocations for social policies, healthcare, and education, risks destabilizing public finances and undermining social commitments. The interaction of geopolitical tensions, energy revenues, and evolving sanctions will play a decisive role in shaping Russia's economic future.

This study offers a comprehensive analysis of macroeconomic indicators, trade dynamics, and fiscal imbalances, providing valuable insights into the uncertainties facing the Russian economy.

Keywords:
Russian economy, inflationary pressures, sanctions, Central Bank of Russia, energy sector, fiscal policy, trade dynamics, macroeconomic indicators, geopolitical tensions

Key Macroeconomic Indicators

The Russian economy is currently exhibiting signs of severe overheating, characterized by declining business activity, ruble devaluation, and increasing inflationary pressures. The Central Bank of Russia's policy of maintaining high interest rates has significantly reduced investment activity and further constrained economic growth. As a result, the economy is stagnating, concerns among large businesses are growing, and prices are rising.

Let us first examine the main macroeconomic indicators. According to the Russian Ministry of Economic Development, the country's GDP grew by 4% in the first nine months of 2024. Moderate economic growth is forecasted for 2025 and 2026.

As for inflation, the consumer price index in Russia increased by 8.88% year-on-year as of November 2024[1]. On October 25, the Central Bank revised its inflation forecast for 2024 upward from 6.5–7.0% to 8.0–8.5%, and for 2025 from 4.0–4.5% to 4.5–5.0%.

Analysts expect unemployment in Russia to fall to 2.4% in 2024, rise to 2.6% in 2025, 2.8% in 2026, and return to 3.0%—the 2023 level—in 2027[2].

One of the main factors currently impacting the Russian economy is the Central Bank's key interest rate, which is used to regulate the liquidity of the banking sector[3]. This rate was 9.5% on September 14, 2022, just before Russia's military intervention in Ukraine. On October 10, 2024, the Central Bank raised the benchmark rate to 21%, and it is expected to increase further to 23% on December 20, 2024, to support the ruble's exchange rate in the medium term.

Regarding the ruble's exchange rate, Sovcombank's chief analyst Mikhail Vasilyev predicts that by the end of 2024, the dollar will trade at 97–104 rubles, the euro at 103–110 rubles, and the yuan at 13.2–14.2 rubles. Forecasts suggest that the USD/RUB exchange rate will average 92.6 rubles per dollar in 2024 (with an expected rate of 103 rubles per dollar in December 2024), 102 rubles per dollar in 2025, 104 rubles per dollar in 2026, and 106.6 rubles per dollar in 2027. This indicates that the ruble's exchange rate against the dollar will weaken by 6.6–7.4% between 2025 and 2027 compared to October 2024.

[1] https://xn----ctbjnaatncev9av3a8f8b.xn--p1ai/
[2] https://www.cbr.ru/statistics/ddkp/mo_br/
[3] https://www.consultant.ru/document/cons_doc_LAW_12453/17fba08beba663f92037428f6679a67af1573307/

Foreign Trade and Balance of Payments

One significant factor contributing to the ruble's devaluation is the observed changes in Russia's foreign trade and balance of payments. Forecasts indicate that Russia's exports of goods and services will amount to $427.6 billion in 2024, $475 billion in 2025, $480 billion in 2026, and $482 billion in 2027. This devaluation could potentially pose risks to the economy. Actual figures show that exports were $492.3 billion in 2021, $486 billion in 2022, and $424.5 billion in 2023[4]. Thus, Russia's expected exports for 2024 will be $64.7 billion, or 13.1%, lower than in the pre-war year of 2021[5].

For the first 10 months of 2024, Russia's exports totaled $354.4 billion, while imports amounted to $229.8 billion[6].

Regarding imports of goods and services, forecasts show that without significant changes, this indicator will be $371 billion in 2024, $382 billion in 2025, $395 billion in 2026, and $401 billion in 2027. Russian imports were $304 billion in 2021, $276.5 billion in 2022, and $303.8 billion in 2023. According to the Ministry of Economic Development, Russia's expected imports for 2024 are forecast at $294.9 billion, $9.1 billion, or 2.9%, lower than in 2021.

As evident, Russia's exports and imports have declined since its military aggression against Ukraine. Since the pace of export reduction surpasses that of import reduction, the positive balance of foreign trade turnover is shrinking, which inevitably reduces the current account surplus of the balance of payments.

---

[4] https://tass.ru/ekonomika/21797047
[5] https://www.cbr.ru/statistics/ddkp/mo_br/
[6] https://www.alta.ru/external_news/115416/

Budget Imbalances and Military Prioritization

Regarding the consolidated budget, analysts have kept their forecasts for the deficit the same in the coming years compared to the October 2024 survey. The consolidated budget deficit is expected to amount to 1.7% of GDP in 2024, 1.1% in 2025, and 1.0% in 2026 and 2027. Before Russia's military aggression against Ukraine, in 2021, the Ministry of Finance reported a federal budget surplus of 0.4% of GDP[7]. Even in 2022, when the Russia-Ukraine war began, the federal budget surplus rose to 1.0% of GDP. However, Russia's federal budget has been running deficits since last year.

As for the 2025 budget, more than 40% of expenditures, equivalent to 8% of GDP, will be allocated to defense ($131.1 billion at the current exchange rate) and national security ($33.3 billion), marking the highest level of military spending in Russia's history. As a result, every two rubles out of five allocated in the 2025 budget will go toward war, with daily war expenditures amounting to $450 million. Consequently, next year, military spending will surpass the combined allocations for social policy, healthcare, education, and economic development.

It is worth noting that 39% of Russia's population (approximately 57 million people) relies on direct payments from the budget. This includes pensioners, public officials, military personnel, and healthcare and education workers. This number does not include employees of state-owned enterprises and contractors receiving budget orders. Additionally, when accounting for 50.3 million retail borrowers and 28 million self-employed individuals and small business workers, 135.3 million Russians directly or indirectly benefit from the budget.

Under these circumstances, the imbalance in the expenditure section of Russia's federal budget due to increased military and defense spending could lead to difficulties in fulfilling social obligations.

[7] https://www.interfax.ru/business/816277

Sanctions and their impact

Moderate economic growth is expected in 2025. Russia's economy is overheating (demand exceeds supply), prompting the Central Bank to tighten monetary policy to cool demand and slow inflation. High interest rates, the sole tool for combating inflation, severely undermine investment activity.

For 2025, the main risks to Russia's economy include recessionary expectations, the negative impact of high credit rates on investments, ruble devaluation, inflation, labor shortages, declining consumer purchasing power, and restrictions on foreign trade payments.

On December 11, 2024, permanent representatives of the European Union (EU) member states approved the 15th package of sanctions against the Russian Federation in Brussels. According to European Commission President Ursula von der Leyen, the restrictions under this sanction package target a group of tankers known as the “shadow fleet.” The new sanctions will prohibit an additional 52 tankers from accessing EU ports, aiming to curb Russia's “shadow fleet.” These tankers are reportedly used by Russia to bypass restrictions imposed by the G7 and their partners for exporting oil and petroleum products.

The sanctions list will also include new individuals and companies aiding in circumventing Western restrictions. These measures are expected to be formally adopted by EU foreign ministers on December 16, 2024. Upon approval, 52 oil and gas tankers that facilitate Russia’s multimillion-dollar fuel sales will be blacklisted[8]. Reports indicate that the EU is already preparing a 16th sanctions package, expected to be introduced around the third anniversary of Russia’s military aggression against Ukraine. This upcoming package is anticipated to be more “comprehensive.”

Before this, by October 2024, the collective West had imposed more than 15,600 sanctions against Russia. The scope of these sanctions has varied, targeting sectors ranging from energy and aviation to retail[9]. Additionally, nearly 1,500 individuals and about 350 entities in Russia faced financial sanctions between February 2022 and July 2024[10]. Furthermore, over 1,000 foreign companies have publicly announced scaling back or fully exiting their business operations in Russia since

[8] https://www.politico.eu/article/eu-sanctions-russia-fleet-ukraine-ships-diplomat-foreign-ministers-kremlin-war-joint-letter-gas/
[9] https://www.finam.ru/publications/item/mozhet-li-ekonomika-rossii-rasti-pod-sanktsiyami-20241010-1030/
[10] https://russiancouncil.ru/analytics-and-comments/analytics/politika-sanktsiy-es-v-otnoshenii-rossii-posle-fevralya-2022-g-napravleniya-izmeneniy/

2022. Initially, these sanctions were expected to collapse the Russian economy. However, while they caused an initial shock, the Russian economy soon began to recover.

This resilience can be attributed to the sanctions imposed after Russia's annexation of Crimea in 2014, which spurred local production based on outdated equipment and technologies to replace imports. During that time, the development of the processing industry, particularly agricultural production, accelerated. Consequently, by the time of Russia's second military intervention in Ukraine, the country had achieved relatively high self-sufficiency in essential food products[11].

According to Rosstat data, in 2020, Russia's self-sufficiency levels were as follows: potatoes (89.2%), milk (84.0%), meat (100.1%), vegetables and melons (86.3%), and fruits and berries (42.4%)[12]. That year, Russia ranked 24th globally in food security, with a score of 73.7 out of 113 countries. However, in 2019, Russia ranked 42nd, scoring 69.7 out of 100[13].

Experts remain divided on the effectiveness of sanctions against Russia. While prominent economist Sergey Guriev has acknowledged the functionality of sanctions, some analysts argue that expectations surrounding their efficacy have been overstated[14]. I believe there is significant truth to the claim that these expectations have not been fully realized[15].

For example, the G7 and EU introduced a $60-per-barrel price cap for Urals crude transported by sea on December 2, 2022[16]. However, according to Russia's Ministry of Finance, the average price of Urals crude was $62.99 per barrel in 2023 and $69.2 per barrel from January to September 2024[17]. In comparison, the average price in 2022 was $76.09 per barrel. Although the price cap aimed to limit Russian oil revenues, Urals crude prices have consistently exceeded the cap, although remaining below 2022 levels.

This indicates that while sanctions are operational, they are not entirely effective. As a result, Russia's income from energy resource sales has increased by more than a quarter over the past

---

[11] Ibadoghlu, Gubad, Gains and Losses of the Russian Economy One Year Later of the War (March 28, 2023). Available at SSRN: https://ssrn.com/abstract=4403162 or http://dx.doi.org/10.2139/ssrn.4403162

[12]https://icss.ru/images/macro/%D0%98%D0%9A%D0%A1%D0%98_%D0%A1%D0%A5%20%D0%B1%D0%B5%D0%B7%D0%BE%D0%BF%D0%B0%D1%81%D0%BD%D0%BE%D1%81%D1%82%D1%8C.pdf

[13] https://www.rbc.ru/business/04/03/2021/603f75f69a7947b7a8cda8cb

[14] https://forbes.kz/articles/sergey_guriev_antirossiyskie_sanktsii_rabotayut

[15] https://www.svoboda.org/a/zavyshennye-ozhidaniya-kak-rabotayut-sanktsii-v-otnoshenii-rossii/33116109.html

[16] https://www.reuters.com/business/energy/holdout-poland-approves-eus-60-russian-oil-price-cap-with-adjustment-mechanism-2022-12-02/

[17] https://www.forbes.ru/biznes/503913-minfin-nazval-srednuu-cenu-nefti-marki-urals-v-2023-godu

year. According to the Ministry of Finance, oil and gas revenues in the federal budget for January–November 2024 rose by 25.7% compared to the same period in 2023, reaching almost $100 billion.

New initiatives are increasingly needed to reduce Russia's revenues from energy carrier sales. One notable initiative is the decision by the U.S. Treasury on November 21, 2024, to impose sanctions on "Gazprombank," "BCS Bank**," "**Centrocredit Bank," and other credit organizations[18]. If this decision takes effect on December 20, countries importing Russian gas—including Hungary, Austria, Serbia, and Turkey—will be unable to conduct financial transactions with "Gazprombank" for their gas purchases.

It is worth noting that after President Vladimir Putin signed Decree No. 172 on March 31, 2022, concerning the "special procedure for fulfilling obligations by foreign buyers to Russian natural gas suppliers," all countries purchasing Russian pipeline gas made payments through "Gazprombank." According to this decree, European countries paying for Russian gas could only do so in foreign currency deposited into special accounts at "Gazprombank." However, on December 5, 2024, Putin signed a decree nullifying the provision requiring payments for Russian gas to be processed exclusively through "Gazprombank."[19]

[18] https://home.treasury.gov/news/press-releases/jy2725
[19] http://publication.pravo.gov.ru/document/0001202412050016?index=1

Russia's Gas Exports challenges and EU Energy Security

Russia still accounted for 15% of the EU's total gas imports in 2023, behind Norway and the US at 30% and 19% respectively, and ahead of North African countries at 14%, according to data from the European Commission. Much of that gas arrives in pipelines crossing Ukraine and Turkey[20]. The main buyers of Russian gas delivered via pipelines in Europe are Greece, Serbia, Bosnia and Herzegovina, Austria, Slovakia, Croatia, Italy, and Hungary. Notably, Slovakia acts as a transit country for flows directed from Ukraine's gas system to Austria, the Czech Republic, Hungary, Germany, and Italy, positioning itself as a distribution hub for Central Europe. Similarly, Turkey aims to become a hub for Russian gas distribution in Southern Europe.

Russian gas is delivered to these countries by pipeline through 2 routes. The first is the transit gas pipeline through Ukraine. Under a five-year agreement signed in Paris in 2019, Russian gas has been transported to Europe via Ukraine. This agreement, however, is set to expire on December 20, 2024. Through this pipeline, 15 billion cubic meters of gas were delivered annually to Europe, with 2 billion cubic meters allocated to Moldova, particularly the Transnistria region, and 13 billion cubic meters sent to Austria and Italy.

Discussions are ongoing about either extending the agreement or using this pipeline to transport approximately 5 billion cubic meters of Azerbaijani gas to Europe through Ukraine. Recently, Ukrainian President Volodymyr Zelensky announced[21] that natural gas deliveries to Europe via this route would cease after December 31, 2024. If this occurs, the idea of transporting Azerbaijani gas to Europe through this pipeline may also fail, bringing discussions on this topic to an end.

The second is the" Turkish Stream" gas pipeline. The "TurkStream" pipeline facilitates the export of natural gas from Russia to Turkey through the Black Sea[22]. The project comprises two parallel pipelines, each capable of transporting up to 15.75 billion cubic meters of gas annually, making the total capacity 31.5 billion cubic meters per year[23]. Through the "TurkStream" and "Blue Stream" pipelines crossing the Black Sea, natural gas is supplied to Turkey and, via another pipeline, to Southeastern European countries, including Bulgaria, Serbia, Romania, and Hungary, as well as the Balkans and Central Europe.

---

[20] https://www.bloomberg.com/news/articles/2024-09-27/why-europe-can-t-give-up-russian-gas-despite-sanctions-over-ukraine
[21] https://tass.com/economy/1834647
[22] https://www.turkstream.info/r/84BA6992-3B20-4A8D-AD2E-7B9C2F506515/TurkStream_General_factsheet_RU_2018_2.pdf
[23] https://sgp.fas.org/crs/row/IF11177.pdf

Last year, 13.5 billion cubic meters of gas were exported to Europe via this pipeline. Serbia and Bosnia and Herzegovina meet 100% of their natural gas needs through “TurkStream.” In fact, 61% of the pipeline's transit volumes are directed to the Western Balkans and Hungary. In 2023, approximately 20% of the gas delivered via this pipeline went to Greece, 16% to Romania—covering the majority of Moldova's gas consumption and about 10% of Romania's gas supply. Less than 3% of the gas was supplied to North Macedonia.

Specifically, through “TurkStream,” 3.5 billion cubic meters of gas are delivered to Serbia, 6.5 billion cubic meters to Hungary, and 2.7 billion cubic meters to Greece, with the remainder sent to North Macedonia[24].

For reference, under a 15-year agreement signed with Gazprom in 2021, Hungary was to receive 4.5 billion cubic meters of gas annually. However, starting in 2022, Hungary has been importing additional volumes of Russian gas beyond the agreed quantities to ensure the security of its gas supply.

In 2023, 21.3 billion cubic meters of gas were sent from Russia to Turkey[25]. Turkish Foreign Minister Hakan Fidan, in a press statement[26], criticized the United States' decision to impose sanctions on Gazprombank, stating that more than 40% of Turkey's gas imports depend on Gazprom.

Toward the end of 2023, it was reported that Gazprom and BOTAS were working on a concept for a natural gas hub in Turkey to compensate for Gazprom’s lost sales to Europe. Considering that Gazprom currently utilizes only two-thirds of the capacity of the two pipelines directly connecting Russia and Turkey through the Black Sea—namely, the “Blue Stream” and “TurkStream”—Russia has the potential to increase gas sales to Turkey by an additional 8–10 billion cubic meters annually.

Kremlin Spokesperson Dmitry Peskov stated that U.S. sanctions against Gazprombank could be interpreted as an attempt to obstruct gas supplies to Europe.

[24] https://csd.eu/fileadmin/user_upload/publications_library/files/2024_6/2024-05-29_Strategic-Decoupling_Policy-Brief_WEB__1_.pdf
[25] https://www.osw.waw.pl/en/publikacje/analyses/2024-06-03/turkey-opportunities-and-challenges-domestic-gas-market-2024
[26] https://www.dwturkce1.com/tr/d%C4%B1%C5%9Fi%C5%9Fleri-bakan%C4%B1-fidandan-abdye-gazproma-yapt%C4%B1r%C4%B1m-ele%C5%9Ftirisi/a-70853252

According to Bloomberg[27], the European Union is pressuring the United States to find ways to ease sanctions on Gazprombank, which plays a central role in Russian gas supplies to Europe. Sources cited by the publication revealed that some European governments and companies have started discussing options and the scope of relaxing sanctions after warnings that restrictions could pose risks to regional gas supplies.

Bulgarian Energy Minister Vladimir Malinov warned that if no alternative mechanism is found to settle accounts with Gazprom following U.S. sanctions, Bulgaria will halt the transit of Russian gas through the Balkan Stream pipeline. The Balkan Stream pipeline extends from Turkey through Bulgaria and Serbia to Hungary.

If sanctions are imposed, all companies purchasing gas through Gazprombank will need to find intermediaries. However, analysts caution that intermediary companies could also face secondary sanctions, making this approach unlikely to succeed. Some energy experts believe Bulgaria is unlikely to halt the transit of Russian gas, which is critical for countries like Serbia and Hungary.

Although Bulgaria does not use gas from the Balkan Stream pipeline, it earns over 150 million euros annually from the transit. Halting Russian gas transit would significantly impact Serbia, Hungary, and Austria during the winter. Notably, unlike other European countries, neither Serbia nor Hungary has taken steps to reduce reliance on Russian gas during the past two and a half years since the war in Ukraine began. Austria has even increased its gas purchases from Russia during this period. In fact, Austria increased its dependence on Russian gas to 98% (up from 80% before the war), reversing the initial decision to reduce Russia gas imports in the fall of 2022. The Austrian oil major, OMV, has a longterm supply contract with Gazprom ending in 2040.

Hungarian Foreign Minister Péter Szijjártó admitted that the latest sanctions “could cause significant challenges in the region.” He stated that the Budapest government would coordinate with Bulgaria and Azerbaijan to address the situation[28].

Meanwhile, the Associated Press reported[29] that the United States plans to impose sanctions on the Petroleum Industry of Serbia (NIS), a state-owned monopoly in Serbia’s gas distribution network. NIS is owned by Gazprom Neft, a Russian state-owned oil company. The sanctions will take effect on January 1. If implemented, this could complicate Azerbaijan’s gas exports to Serbia.

---

[27] https://www.bloomberg.com/news/articles/2024-12-06/eu-in-talks-with-us-to-mitigate-effect-of-russian-bank-sanctions?embedded-checkout=true
[28] https://www.euractiv.com/section/politics/news/bulgaria-to-stop-russian-gas-transit-unless-gazprom-pays/
[29] https://apnews.com/article/serbia-russia-us-gazprom-sanctions-b4f14fb3b710d9fea4f013ecf41d63a0

For reference, Azerbaijan began exporting gas to Serbia in 2024. Under a September agreement, Azerbaijan will deliver 1 billion cubic meters of gas annually to Serbia, meeting one-third of the country’s demand.

Gas supplies from Russia and Azerbaijan to Europe may face new challenges in 2024. Suppose Russia halts gas transit through Ukraine by the end of this year. In that case, the TurkStream pipeline, a major gas pipeline project that delivers Russian gas to Greece, the Western Balkans, and Hungary, will become the sole and most significant source of Russian gas exports to Europe.

In light of this, the United States has announced plans to impose sanctions on Gazprombank to disrupt gas transit through the TurkStream pipeline and halt Russian pipeline gas imports to Europe entirely after the transit of Russian gas through Ukraine ends in late 2024. If these sanctions are implemented, they could significantly reduce Russia’s gas revenue, which tops the list of its foreign trade commodities. This potential economic pressure could weaken Russia’s ability to fund its war efforts, as the country relies heavily on oil and gas revenues.

Conclusion

The effectiveness and outcomes of such sanctions are uncertain and will determine whether they achieve their intended impact. This uncertainty adds to the suspense and anticipation of the future developments in the energy politics and international relations.

Overcoming many of these challenges in 2025 will depend on the revenues generated from the country's energy resource sales. According to the Ministry of Finance, Russia's revenues from energy resource sales in the first 11 months of 2024 increased by approximately 26% compared to the same period in 2023, reaching 10.3 trillion rubles ($98.8 billion at the current exchange rate). This amount exceeded the forecasted level by 1.2 trillion rubles ($11.5 billion). The Ministry of Finance attributes this primarily to the rise in Russian oil prices, with the local "Urals" crude consistently selling above the $60 per barrel price cap set by the West for over a year and a half. Analysts suggest that U.S. and EU efforts to limit Moscow's hydrocarbon revenues have failed. However, the U.S. is expected to impose stricter sanctions on Russia's energy sector, which could significantly impact the country's economic stability.