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ANALYSIS

Policy Brief: Russia's Wartime Economy – Current State and Outlook

AUTHOR

Edvardas Lukošius

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Since the beginning of Russia's war against Ukraine, the main Western measure to pressure Russia to end the war has been aimed at its economy. More than three years of Russia's war of aggression show that its economy has proven to be fairly resilient. This policy brief examines the current state of the Russian economy and assesses the true resilience of its economic system in sustaining the war.

Wartime Growth Is Fading: Macroeconomic and Social Trends

Russia's war-driven growth cycle has peaked. GDP expanded by only 1.4% in Q1 2025, down from 4.5% in late 2024 — the sharpest quarterly slowdown since the invasion began.[1] Official and independent forecasts now project 2025 growth below 2%, with the civilian economy likely in recession as early as March.[2] Industrial production has flattened outside the defence sector, while investment remains weak and consumption has cooled. The temporary stimulus of mobilisation and military procurement, which fueled above-trend growth in 2023–24, has faded. Without structural reform or access to foreign capital, Russia appears to be returning to its pre-war trajectory of stagnation.

Household-level indicators reinforce the picture. Inflation remains near 10%, while nominal wage growth has slowed sharply.[3] Real incomes are now flat or declining, and the ruble's purchasing power continues to erode. Retail sales have slumped after a brief wartime surge, with durable goods—such as cars and electronics—seeing double-digit declines. Passenger vehicle sales alone dropped by 27% year-on-year in January–April 2025.[4] While official unemployment remains at 3.5%, labour force data is distorted by mobilisation, emigration, and statistical exclusions.[5] In effect, households are spending less, saving less, and reporting lower living standards. For now, repression and propaganda are containing unrest. But the war economy is increasingly producing economic fatigue without restoring long-term dynamism.

A Military Economy

Russia's macroeconomic architecture has been repurposed to serve the war. Defence spending now accounts for over 7–8% of GDP and more than 40% of federal expenditures—levels not seen since the Soviet era.[6] This militarised stimulus initially revived output and employment in targeted sectors, especially in arms manufacturing and state-led logistics. Yet by mid-2025, this model is approaching its limit. The stockpiles that enabled early wartime gains are depleted mainly, while sustained mass production requires budget allocations that strain even a heavily repressive system. Civilian investment and non-military growth have been crowded out. With no private sector rebound in sight, the Kremlin's ability to maintain current military outlays without triggering broader economic dislocation is narrowing.

The fiscal cost is mounting rapidly. The federal budget deficit for 2025 has been revised to 3.8 trillion rubles (~$48 billion), tripling in the first four months of the year alone.[7] In April alone, the government ran a monthly shortfall of over 1 trillion rubles. The National Wealth Fund (NWF), once a cushion against external shocks, is being depleted to cover these gaps; its liquid reserves could run dry by 2026 if current burn rates persist.[8] Meanwhile, domestic borrowing is constrained. With foreign markets inaccessible and 10-year bond yields exceeding 16%, the Ministry of Finance

faces negative net issuance, paying more in interest than it receives in proceeds.[9] As debt, reserves, and revenues all tighten simultaneously, the Kremlin may be forced to consider politically and economically destabilising steps such as raising consumption taxes or pressuring the central bank to monetise further.

The war economy has delivered short-term political insulation but not long-term strategic security. Even state-linked analysts now warn that militarisation is cannibalising Russia's future economic potential[10]. Sustaining high defence spending amid stagnant output is eroding both fiscal space and monetary credibility. What remains is a brittle model: one that can fund war today by undermining growth, consumption, and macro stability tomorrow.

Inflation and Financial Fragility

Russia remains trapped in a high-inflation regime. Consumer prices rose by 9–10% year-on-year in early 2025, well above the central bank's target and the government's revised forecast of 7.6%.[11] This marks the return of double-digit inflation for the first time in over two years, driven by budgetary expansion, defence procurement, and a broad money supply that has nearly doubled since the invasion. To contain expectations, the central bank has held its key rate at ~20%, sacrificing credit availability to defend monetary stability.[12] While this policy has helped stabilise the ruble, it has also suppressed business lending and private investment, deepening the slowdown across the civilian economy.

Financial stability risks are mounting. Russia's budgetary expansion and monetary tightening are increasingly at odds: the finance ministry continues to widen deficits, while the central bank struggles to rein in liquidity. To paper over this conflict, authorities have leaned on quasi-fiscal mechanisms—such as encouraging state banks to buy sovereign bonds and refinance through tailored repo facilities—blurring the line between fiscal and monetary spheres.[13] Meanwhile, banks face growing pressure from rising non-performing loans and an inverted yield curve that erodes profitability. Credit is tight, but asset quality is deteriorating. For now, capital controls and central bank buffers have contained systemic risks; however, the equilibrium remains fragile. Any external shock—such as a new round of substantial sanctions or a sharp drop in energy revenues—could expose these underlying imbalances and trigger broader financial distress.

External Adaptation vs Structural Isolation

Cut off from Western markets and financial systems, Russia has engineered an adaptive—but increasingly asymmetric—external realignment. China has emerged as the Kremlin's economic lifeline, with bilateral trade volumes reaching $240 billion in 2023 and remaining elevated. The yuan now facilitates nearly a third of Russia's foreign trade.[14] Russian companies have adopted Chinese payment systems, and yuan-denominated transactions have replaced dollar and euro flows in much of the import/export ecosystem. However, this shift comes at a cost: Chinese dominance in the relationship has grown. Beijing dictates terms on pricing, technology transfer, and logistics, and Chinese firms remain wary of triggering secondary sanctions. Dependency on a single partner—particularly one with strategic leverage—carries long-term geopolitical and economic

risks, locking Moscow into an increasingly subordinate position. Russia's pivot to other Global South partners (e.g., Turkey, India, the UAE) has enabled sanctions circumvention. Still, it cannot replicate the scale or technological depth of pre-war Western ties.

Energy revenues—still the foundation of Russia's war financing—have become structurally impaired. Sanctions and embargoes have cut off core EU markets, forcing Russian producers to sell crude to Asia at steep discounts. Urals crude trades around $53–55 per barrel, far below budgeted assumptions and historical averages.[15] Gazprom's pipeline exports to Europe have declined by ~80% since 2021, while LNG deliveries face decreasing demand amid EU diversification efforts. The result is a permanent downgrade of Russia's energy leverage. Although new deals, such as Power of Siberia-2, may eventually expand exports to China, these projects are capital-intensive, geopolitically contingent, and yield limited short-term fiscal benefits.[16] The Kremlin has responded by drawing on its sovereign wealth fund and issuing high-yield domestic debt, but these are finite tools. Energy dependency now limits not only Russia's revenue base but its strategic flexibility. For the West, this fragility offers a pressure point: tightened enforcement of oil sanctions and maritime restrictions could further erode Moscow's fiscal capacity.[17]

Russia's investment climate has effectively collapsed. Western capital and technology are gone; FDI is negative once outflows are accounted for. The 2025 St. Petersburg Forum—once a symbol of Russian global economic engagement—was marked by the absence of serious foreign participation.[18] De-risking from Russia is now structural: Western banks have exited, equity listings have been revoked, and insurance and reinsurance markets have been severed. Even Chinese and Indian firms avoid large-scale investment in Russia's industrial base, fearing political volatility and secondary sanctions. Domestically, high borrowing costs, legal uncertainty, and forced "militarisation" of corporate activity have crushed private sector confidence.[19] SMEs are in decline, and productive capital formation is stagnating, except in state-sponsored defence and infrastructure projects. In this context, Russia's economic future is underwritten not by innovation or integration but by coercion and inertia. Without external investment or domestic revival, the country's industrial base is set to degrade steadily, eroding long-term power projection despite temporary wartime stability.

Future

Russia's economic trajectory is defined by stagnation under strain. The war economy has delayed collapse but has entrenched long-term vulnerabilities, including low growth potential, weakening reserves, and fiscal erosion. Most forecasts suggest GDP growth at 1-2% in 2025, with risks skewed toward recession. Inflation is expected to stay elevated, monetary policy remains constrained, and the private sector is contracting outside of state-led arms production. What persists is not strength, but rigidity—Russia can sustain current operations, but only through systemic sacrifice.

Three broad scenarios frame the path ahead. In a **status quo scenario**—characterised by continued war intensity and current sanctions—Russia will likely muddle through for 12–24 months. Wartime stimulus will mask underlying decay, but each fiscal year will bring more challenging

trade-offs: more debt, more profound reserve depletion, or austerity. Moscow can manage this grind, but at the cost of future capacity.[20]

A **sanctions relief scenario**—e.g., from geopolitical shifts in Washington—could offer temporary stabilisation. Reaccess to selected markets and financial flows might lift the ruble and ease shortages. Yet structural distortions would persist: demographic loss, low productivity, and war-driven capital misallocation. Any rebound would be shallow and uneven, capped by Russia's post-2022 decoupling from Western capital and technology.[21]

A **third scenario**—tightened Western pressure—offers a strategic opportunity. Stricter enforcement of oil price caps, secondary sanctions on enablers, and reduced dual-use exports could erode Moscow's ability to fund war and replace military losses. This would not trigger collapse but would accelerate degradation. It could also trigger internal budget rebalancing, pitting military needs against social stability. The EU and its allies should press for this outcome: prioritising full sanctions enforcement, targeting transit hubs such as Kazakhstan and Turkey, and lobbying EU and other relevant institutions for tighter export controls on industrial equipment and electronics.[22] Most importantly, the West must intensify and expand existing sanctions against Russia to swiftly undermine its capacity to sustain its war of aggression against Ukraine and prevent any further threats toward NATO's Eastern Flank.

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