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KSE Institute Russia Chartbook

The Russian Economy at the End of 2023: Stumbling, but Not Falling (Yet)

December 2023

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Executive Summary

1. **Effectiveness and credibility of energy sanctions remain on the line.** October-November data suggest that Russia's crude oil exports are increasingly slipping beyond the G7's reach. *First*, compliance with the price cap appears to have been virtually zero in recent months. *Second*, Russia's reliance on its "shadow fleet" continues, meaning that the cap's leverage is fading quickly. Recent steps on stepped-up enforcement are encouraging, but more will be needed to impact Russian macroeconomic stability.
2. **Higher oil export earnings reduce external pressure.** Following a period of low export earnings as wide discounts on Russian oil weighed on prices, we observe a gradual improvement in recent months. The overall current account surplus increased moderately, partially driven by higher goods exports, resulting in higher foreign currency inflows into the Russian economy. Together with the CBR's interest rate cumulative hike by 850 bps and re-introduction of capital controls, this has helped to stabilize the ruble.
3. **Subsiding macroeconomic pressure creates more policy space.** On the fiscal side, revenues from oil and gas rebounded strongly due to higher export prices, robust volumes, and the weaker ruble. At the same time, non-O&G receipts are up as Russia's economy has proven to be resilient and bounced back from the initial shock from the war and sanctions. Russian authorities will likely be able to broadly fulfill the deficit target for this year, leaving macro buffers intact and allowing sharp increase of war spending next year.
4. **Bold action is urgently needed to maintain pressure on Russia.** Sanctions have put a heavy burden on Russian macroeconomic stability in the first half of the year, but their effect appears to be increasingly in question. In particular, the October-November data confirm that problems with price cap enforcement are much bigger than previously expected. We propose three concrete steps that can quickly and effectively address these challenges—and make sure that Russia's policy space remains constricted.

   (1) G7/EU authorities should ensure that authorities have sufficient information to determine if the price cap is complied with.

   (2) EU coastal states should leverage geographical "choke points" to limit Russia's ability to use a shadow fleet of tankers.

   (3) Price cap coalition countries should step up penalties on entities that violate the price cap or facilitate such violations.

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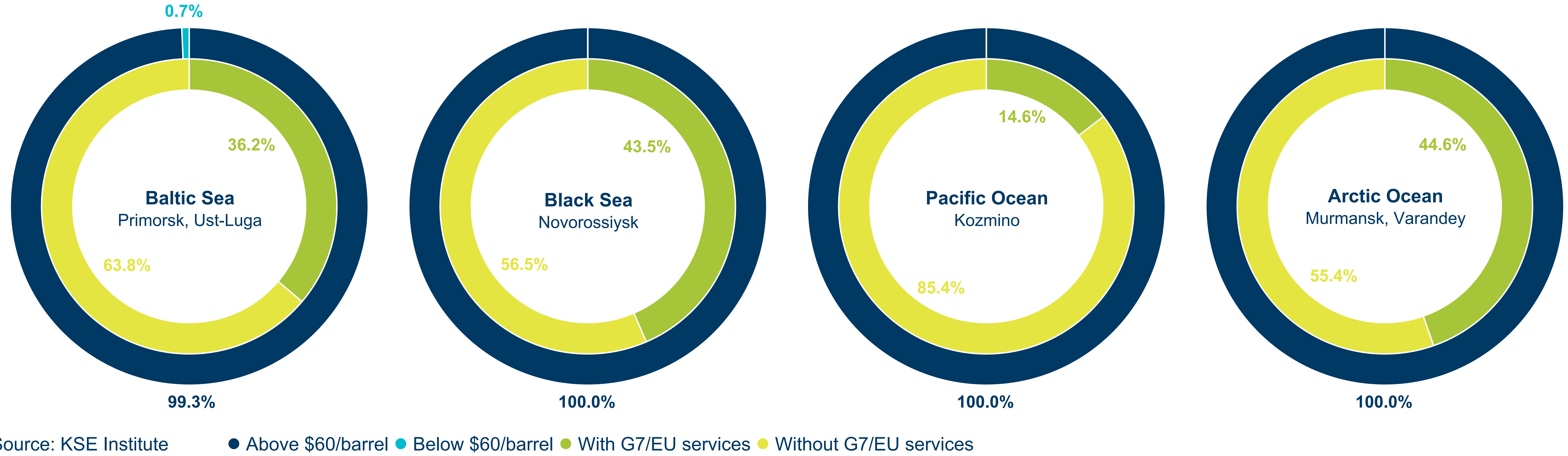
Energy: Russia's oil is slipping increasingly beyond G7 reach as violations appear widespread and the shadow fleet grows.

Data points to evidence for widespread violations of the price cap.

- In October-November, more than 99% of seaborne crude oil exports appear to have been sold above $60/barrel.
- At the same time, one third of the total volume was shipped with the involvement from G7/EU service providers.
- This points to very low compliance with the price cap, likely via falsified pricing information (i.e., attestation fraud)

Read KSE's recent study *Bold Measures Are Needed as Russia's Oil is Slipping Beyond G7 Reach*.

Seaborne exports of Russian crude oil in October-November 2023 by price and service provider



Source: KSE Institute

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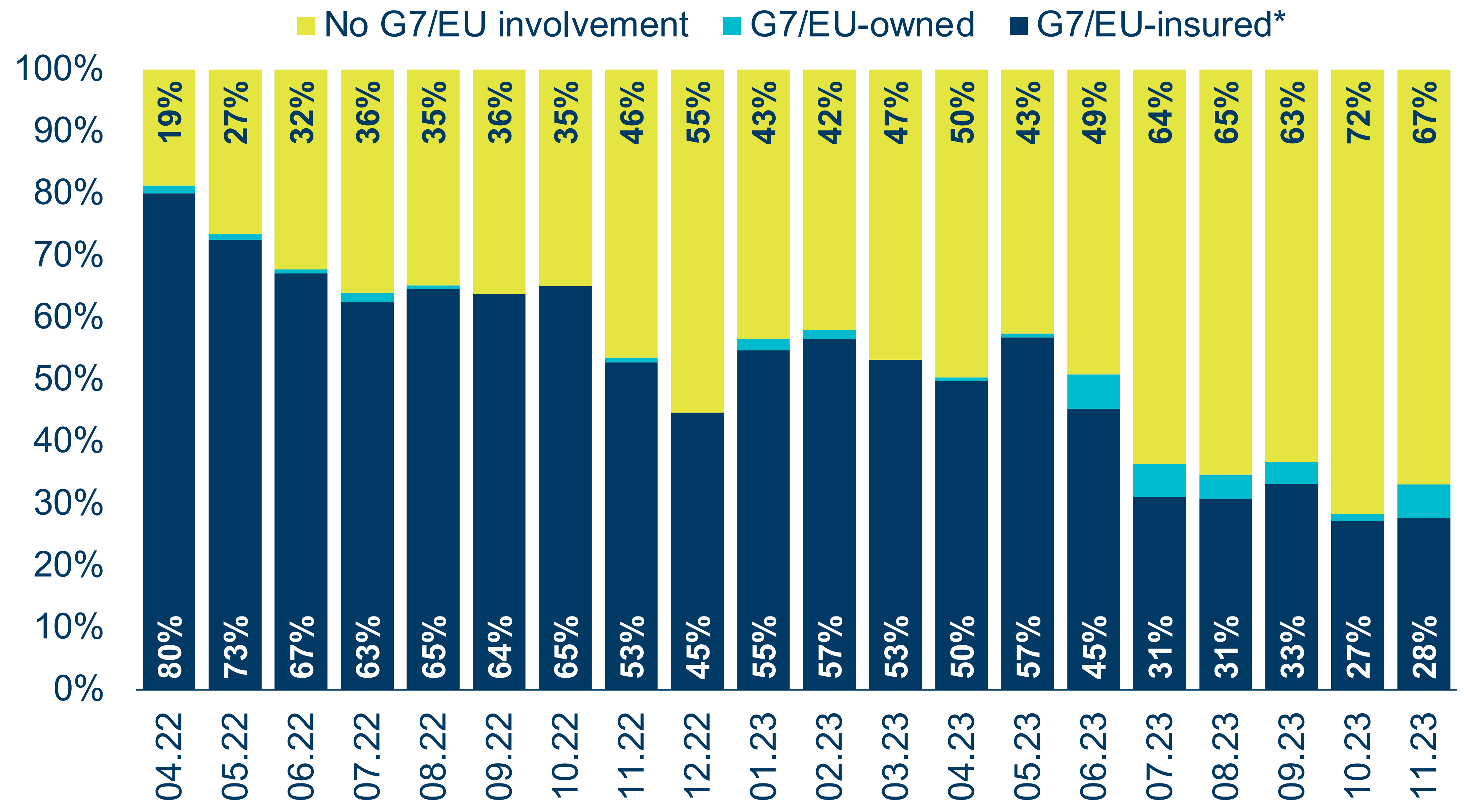
Fundamentally, the price cap's leverage is increasingly under threat.

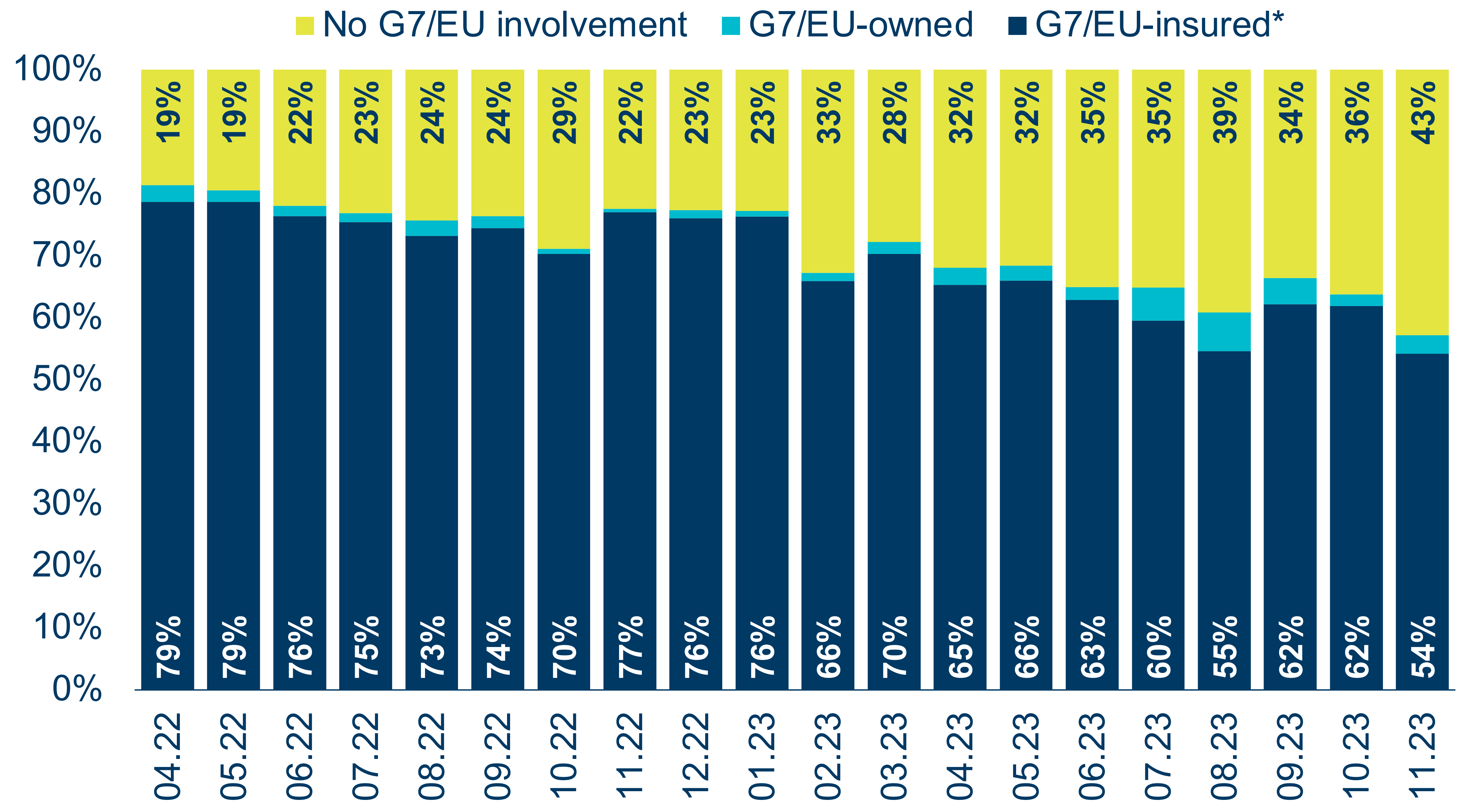
- Russia's reliance on G7/EU-owned and/or -insured vessels has fallen significantly in the case of crude oil.
- In July-November 2023, their share stood at 33.8%—a sharp drop from 51% in H1 2023 and 58% in H2 2022.
- Importantly, we do not observe the same dynamics for oil products where participation is stable at ~55-60%.

Composition of Russian crude oil exports, in %



Source: Kpler, P&I Clubs, KSE Institute

Composition of Russian oil products exports, in %



Source: Kpler, P&I Clubs, KSE Institute

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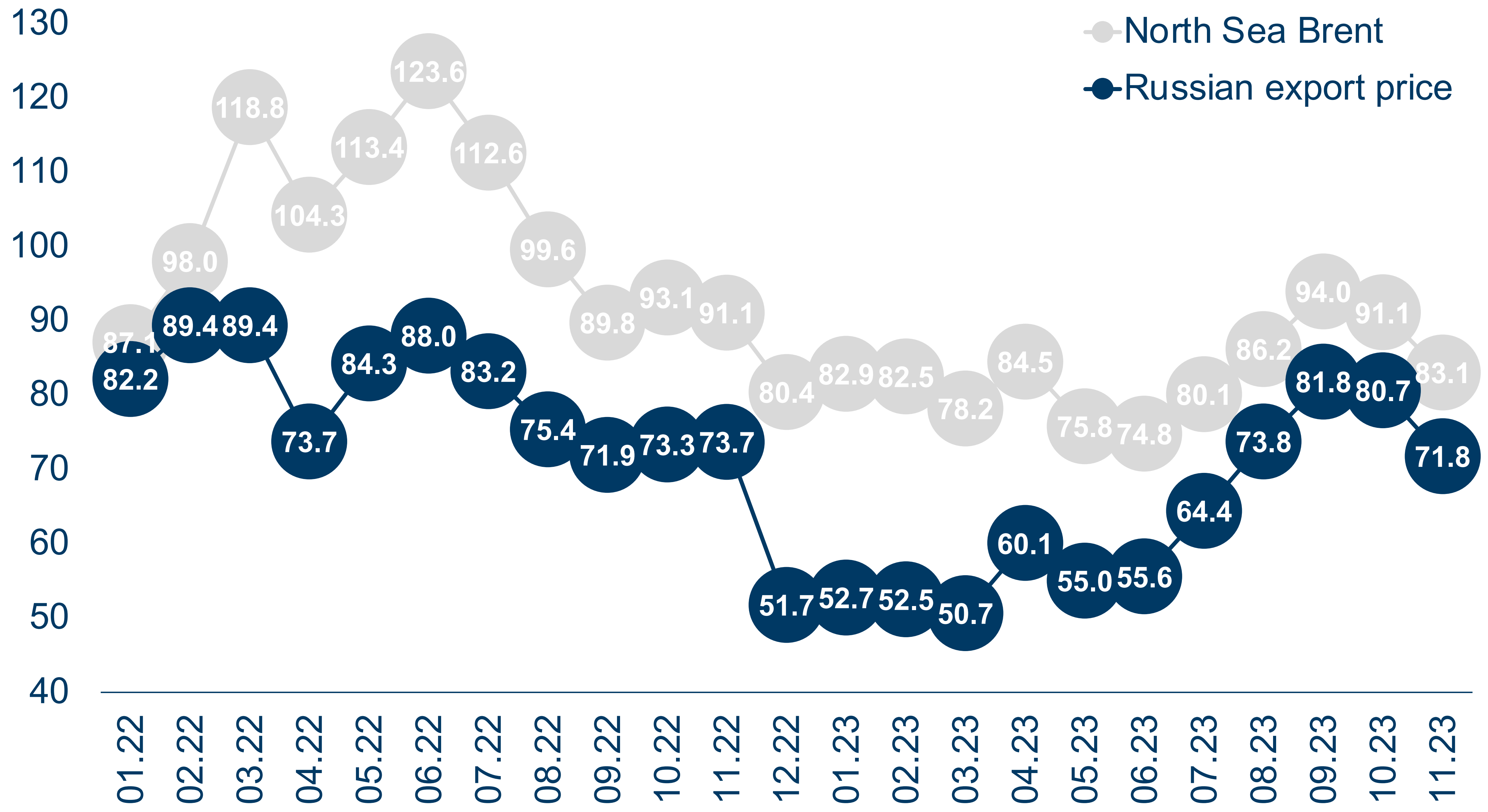
Shrinking discounts threaten key mechanism of energy sanctions.

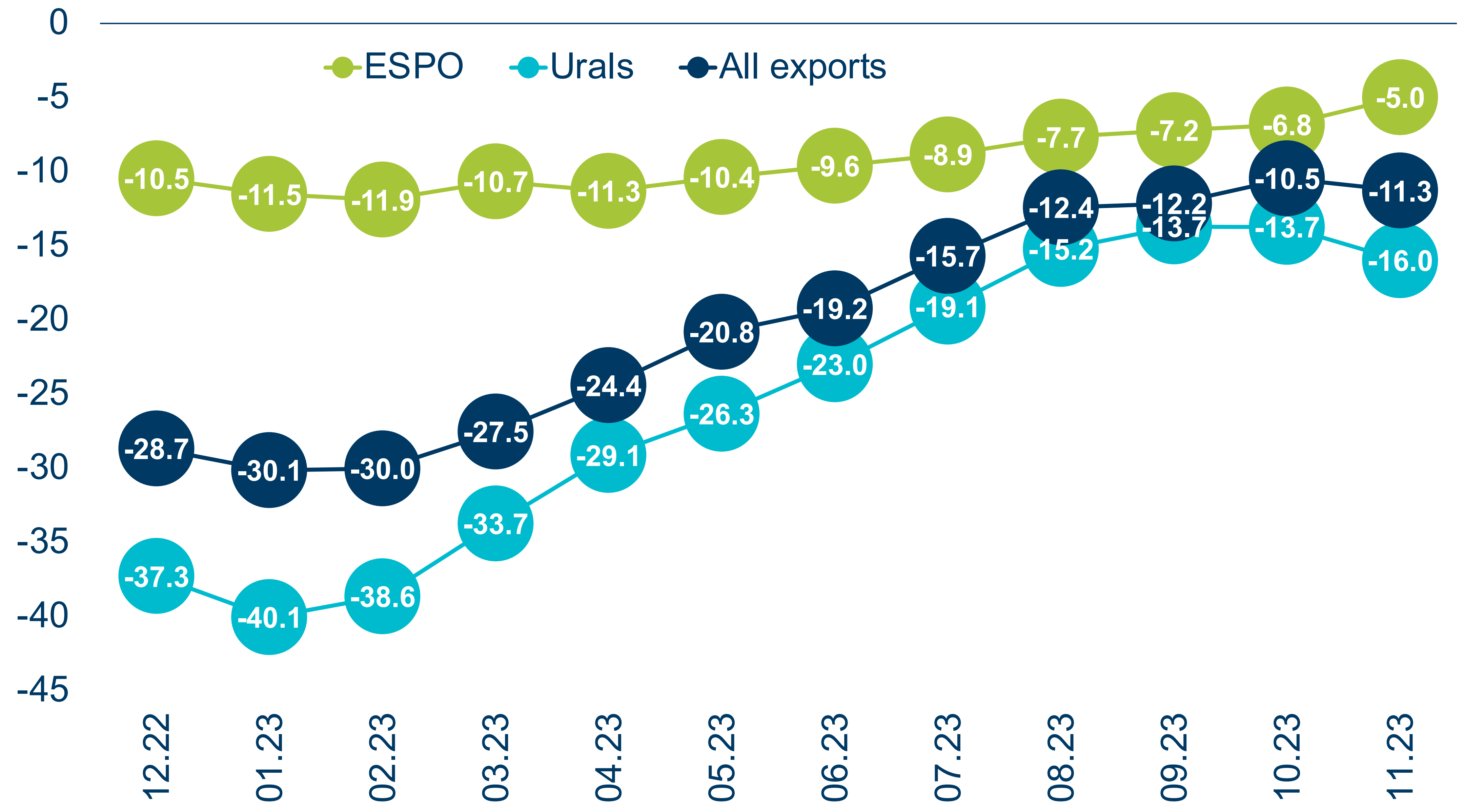
- Energy sanctions, in particular the EU embargo, weighed on Russian exports via sharply wider oil price discounts.
- However, the Urals-Brent spread has narrowed from $40/barrel in January to around/below $15/barrel in H2 2023.
- The moderate widening in November may indicate that recent G7 price cap enforcement efforts have an effect.

Crude oil prices, in U.S. dollar/barrel*



Source: Federal Customs Service, International Energy Agency, KSE Institute
*export price until November 2022 from Russian customs, all other numbers from IEA

Discount of Russian export prices vs. Brent, in U.S. dollar/barrel

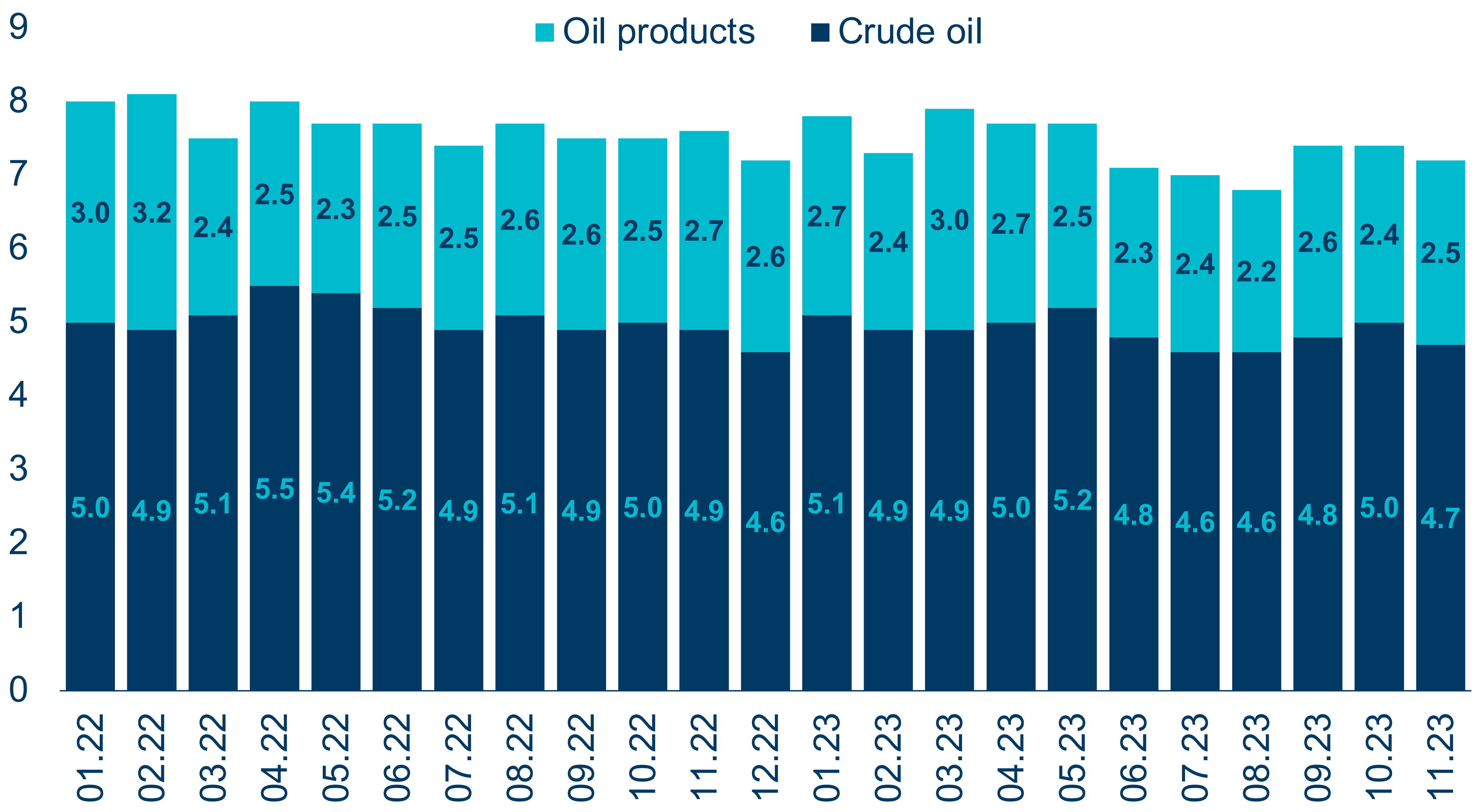


Source: International Energy Agency, KSE Institute

Russian oil export volumes fell by 2.7% in November.

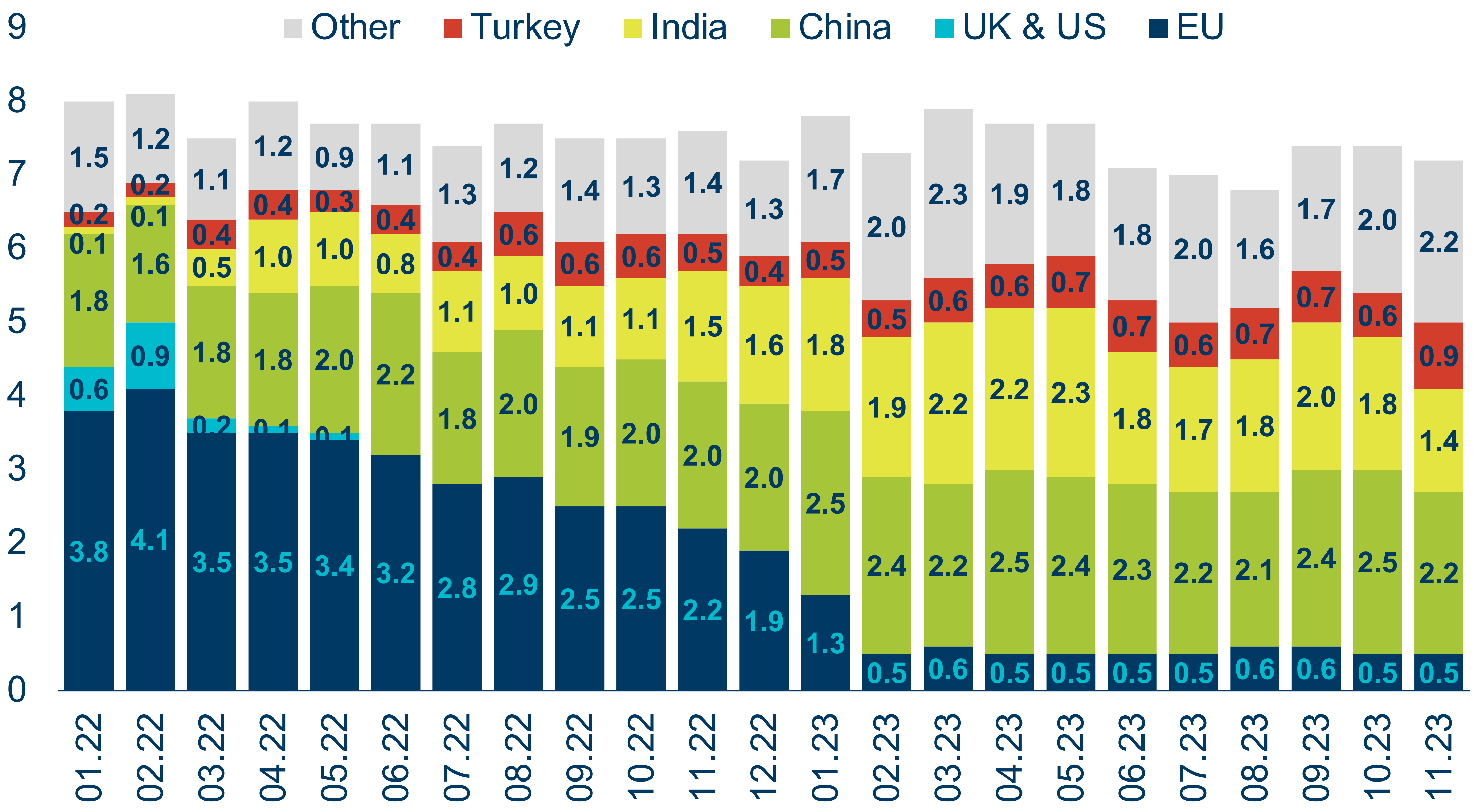
- Russian oil exports fell somewhat in November – down 2.7% vs. September-October to 7.2 million barrels/day.
- Lower shipments to India (1.4 mbd in November vs. 1.8 mbd in October) as well as China play a key role.
- We believe that higher prices for Urals as well as somewhat stronger price cap enforcement are behind this.

Russian oil export volume by type, in million barrels/day



Source: International Energy Agency, KSE Institute

Russian oil export volume by destination, in million barrels/day

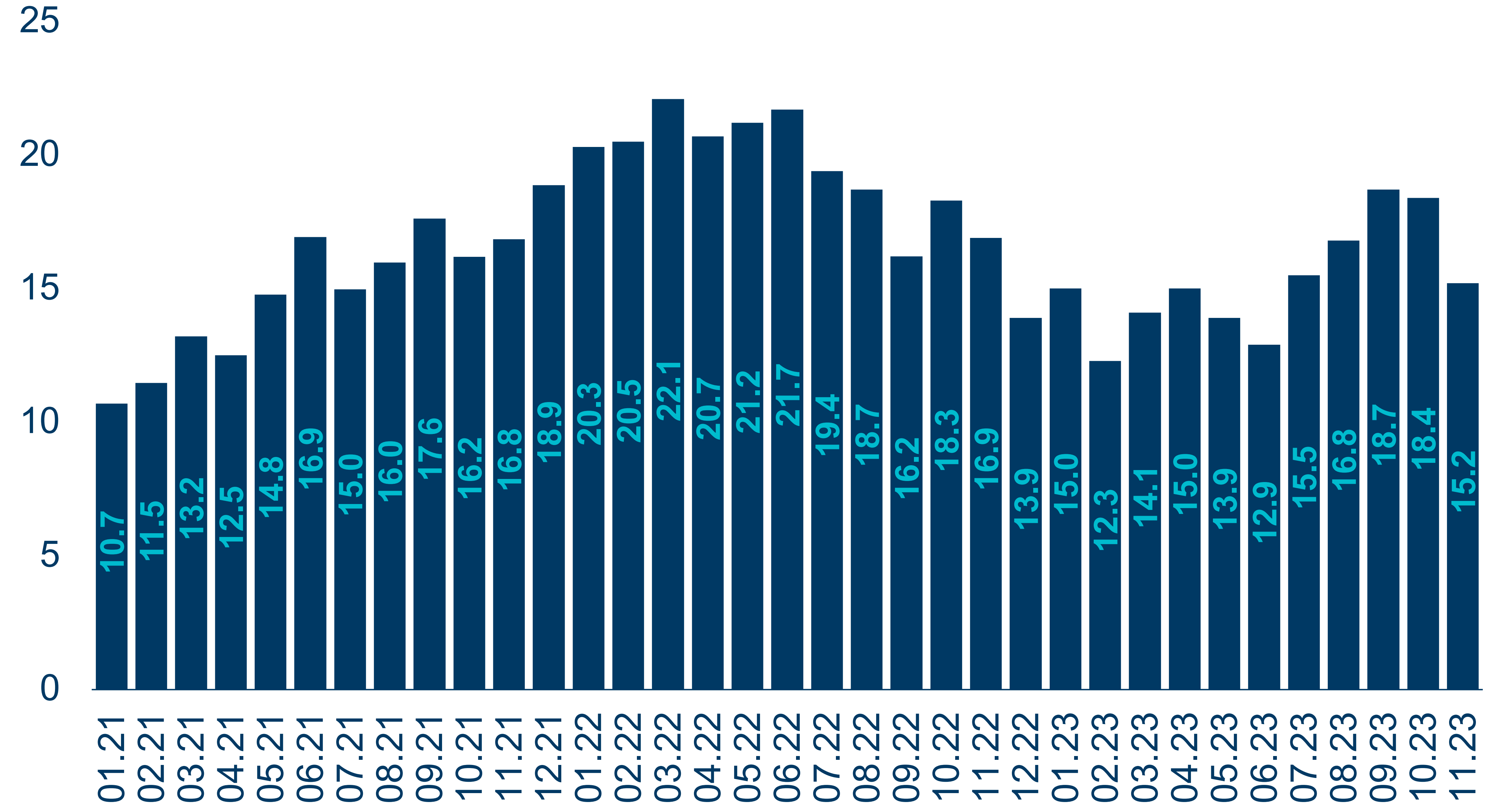


Source: International Energy Agency, KSE Institute

As a result, export earnings and budget revenues recovered in H2 2023.

- After exceeding $18 billion in the two previous months, Russia oil export earnings decreased to $15.2 billion.
- At the same time, the weaker ruble is supporting budget revenues from oil extraction taxes and export duties.
- Ukraine's allies urgently need to take action to improve enforcement and preserve the price cap's leverage.

Oil export earnings, in U.S. dollar billion



Source: Federal Customs Service, International Energy Agency, KSE Institute
*2021 data from Russian customs service, 2022-23 data from IEA

Federal budget oil revenues, in ruble billion*

Source: Ministry of Finance, KSE Institute *includes extraction tax and export duty

Bold measures are needed as Russia’s oil is slipping beyond G7 reach.

The October-November data suggest that problems with price cap implementation and enforcement are much bigger than previously expected. To ensure that sanctions continue to constrain Russia’s ability to wage its war of aggression on Ukraine—and that their credibility is maintained—additional steps urgently need to be taken. Below, we outline three critical measures that can quickly and effectively address Russian effort to evade sanctions on its oil exports.

1. **G7/EU countries should ensure that their authorities have sufficient proof of compliance with the price cap,** including by: a) leveraging the involvement of G7/EU financial institutions in the Russian oil trade and their knowledge of key transaction details such as prices; b) requiring attestations to be provided by reputable entities defined via transparent criteria and subject to sanctions in the case of violations or their facilitation; and/or c) stepping-up of documentary evidence requirements for G7/EU service providers under the current system (including original sales contracts, etc.).
2. **EU coastal states should leverage geographical “choke points” to limit Russia’s use of a “shadow fleet” of tankers** by requiring proper spill insurance for vessels’ passage through their territorial waters, including in the Baltic Sea and Mediterranean. This would force Russia to rely once again on G7/EU services for a substantial share of its exports and also help address environmental risks that have emerged due to the increasing use of old and under-insured tankers. For this purpose, a system to allow for timely and efficient verification of insurance information should be established.
3. **Price cap coalition countries should step up penalties on entities that violate the price cap.** For G7/EU companies, this should include tougher monetary penalties and expanded lockout periods. For third-country actors, price cap coalition countries should impose “direct” sanctions (e.g., SDN listing in the United States or use of the European Union’s anti-circumvention tool established in the 11th package) and consider the application of extraterritorial (“secondary”) sanctions, leveraging the continued critical importance of its financial system for internationally operating businesses.

Trade: reduced effectiveness of energy sanctions; external pressure has subsided somewhat.

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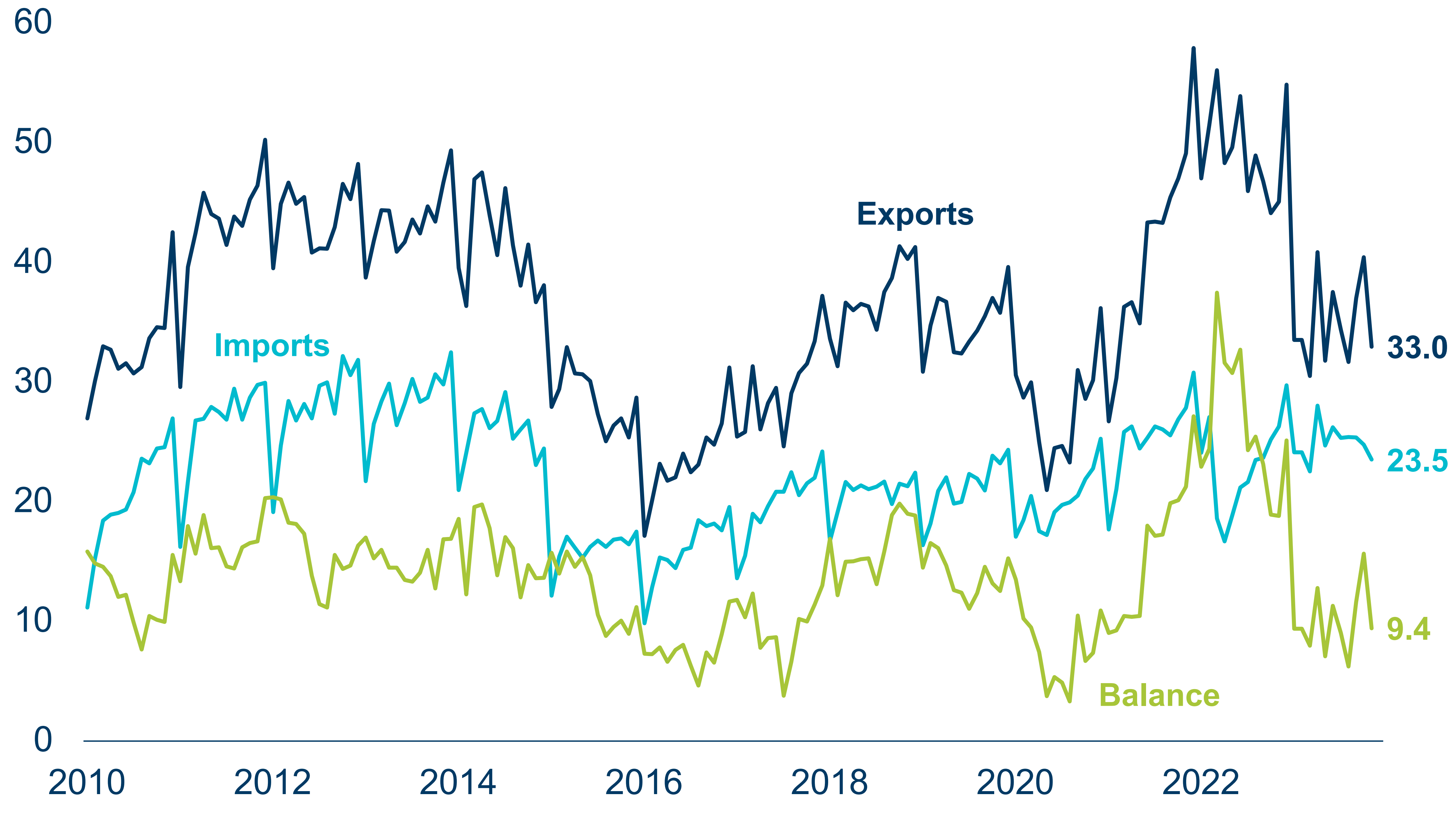
External environment considerably weaker than in 2022.

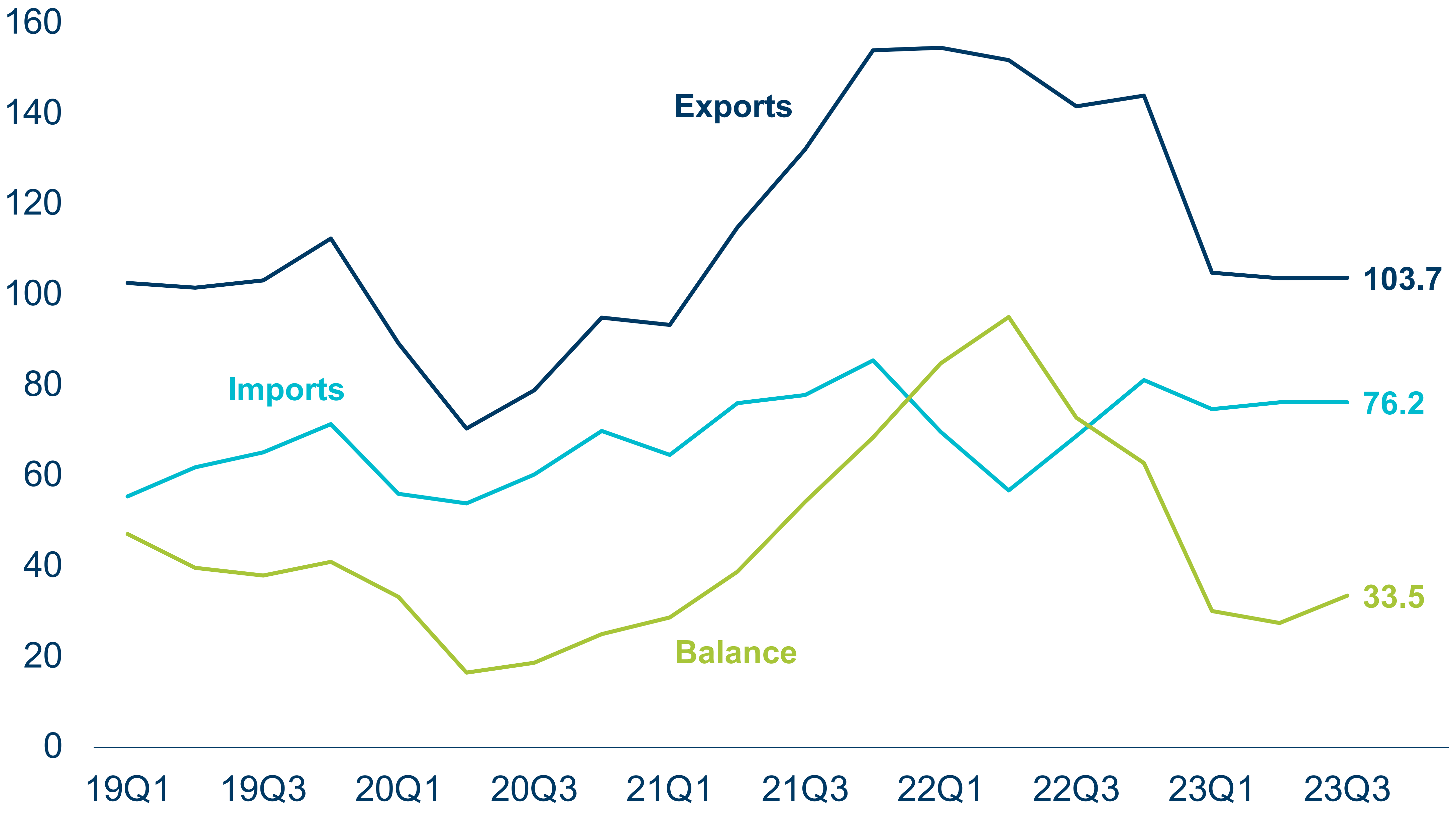
- Higher oil earnings have not led to a meaningful increase in total exports, which continue to fluctuate at suppressed levels.
- With imports broadly stable, this has resulted in a trade surplus of around $10 billion per month in January-October 2023.
- Altogether, the external environment remains much less supportive than last year, but far from any critical pressure.

Monthly trade statistics, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

Quarterly balance of payments statistics, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

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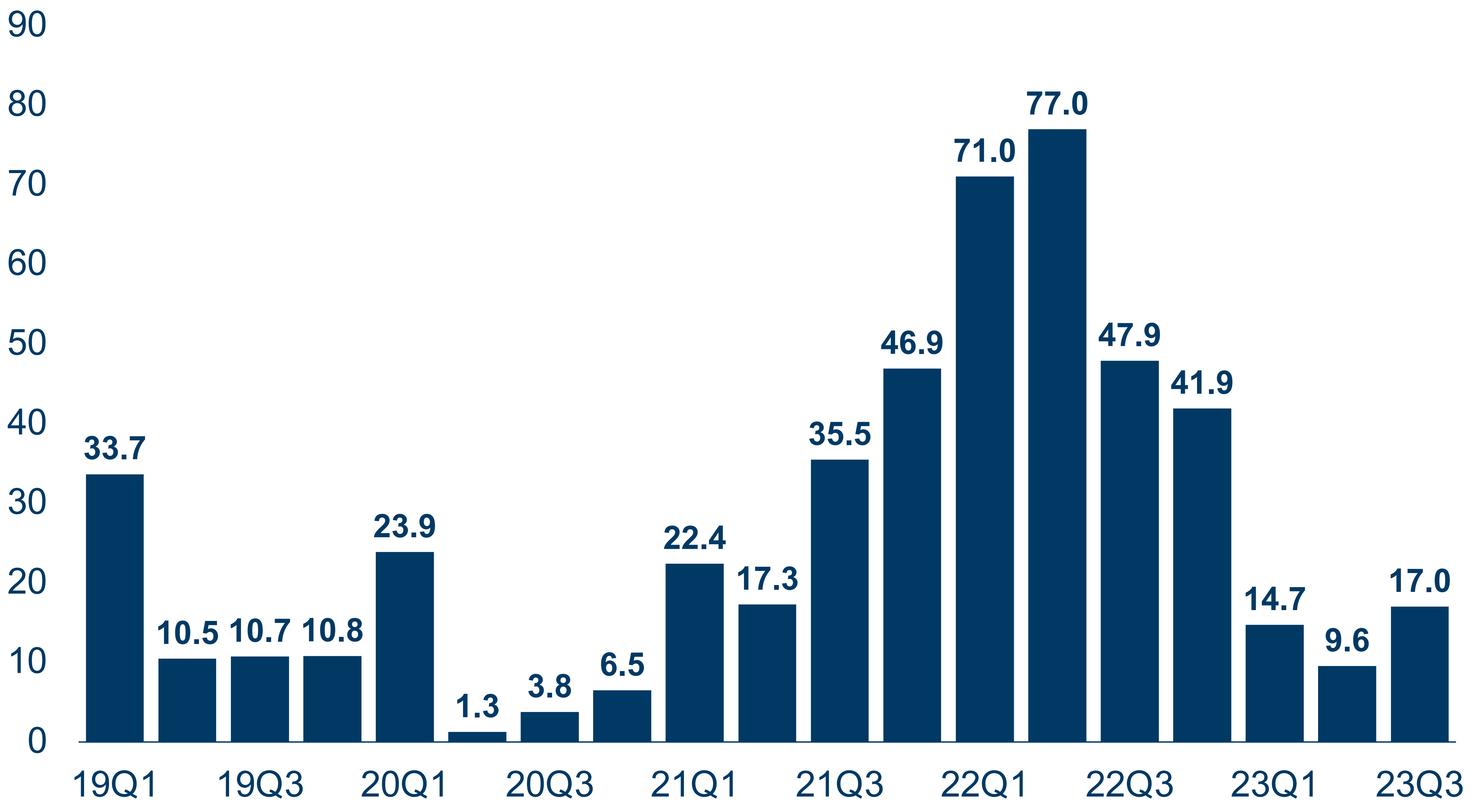
Inflows of foreign currency have dropped vs.

- The overall current account surplus has fallen in line with goods trade dynamics, significantly limiting FX inflows.
- While the surplus bounced back moderately to $17.0 billion in Q3 2023, it remains 78% below its peak in Q2 2022.
- This improvement was driven by a larger goods trade surplus but also a much smaller income and transfers deficit.

Quarterly current account balance, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

Composition of the current account, in U.S. dollar billion

		C/A	Goods			Services			Income & transfers		
	Time period	Bal.	Bal.	Exp.	Imp	Bal.	Cred.	Deb.	Bal.	Cred.	Deb.
	Jul. 2023	0.8	6.2	31.7	25.4	-3.3	3.3	6.6	-2.2	3.5	5.6
	Aug. 2023	5.8	11.6	37.0	25.4	-3.7	3.3	6.9	-2.1	3.3	5.4
	Sep. 2023	10.4	15.6	40.4	24.8	-2.2	3.4	5.5	-3.1	3.6	6.6
	Oct. 2023	4.9	9.4	33.0	23.5	-2.3	3.2	5.5	-2.2	3.4	5.6
	Nov. 2023	4.3	8.4	32.6	24.1	-1.8	3.3	5.0	-2.4	3.1	5.4
	Q1 2023	14.7	30.2	104.9	74.7	-7.3	9.8	17.1	-8.2	10.6	18.8
	Q2 2023	9.6	27.4	103.7	76.2	-8.5	10.4	18.9	-9.3	12.8	22.2
	Q3 2023	17.0	33.5	109.1	75.6	-9.1	10.0	19.1	-7.4	10.3	17.7
	Jan.-Nov. 2023	50.5	109.0	383.2	274.2	-29.0	36.6	65.6	-29.5	40.2	69.7
Memorandum	Q1 2022	71.0	84.8	154.6	69.8	-3.5	13.9	17.4	-10.2	12.6	22.8
Memorandum	Q2 2022	77.0	95.1	151.8	56.7	-3.6	11.1	14.7	-14.4	12.0	26.4
Memorandum	Q3 2022	47.9	72.8	141.7	68.8	-7.0	11.4	18.3	-18.0	12.7	30.7
Memorandum	Jan-Nov. '22	223.0	290.4	537.2	246.8	-19.4	43.5	62.9	-48.0	45.6	93.7

Source: Bank of Russia, KSE Institute

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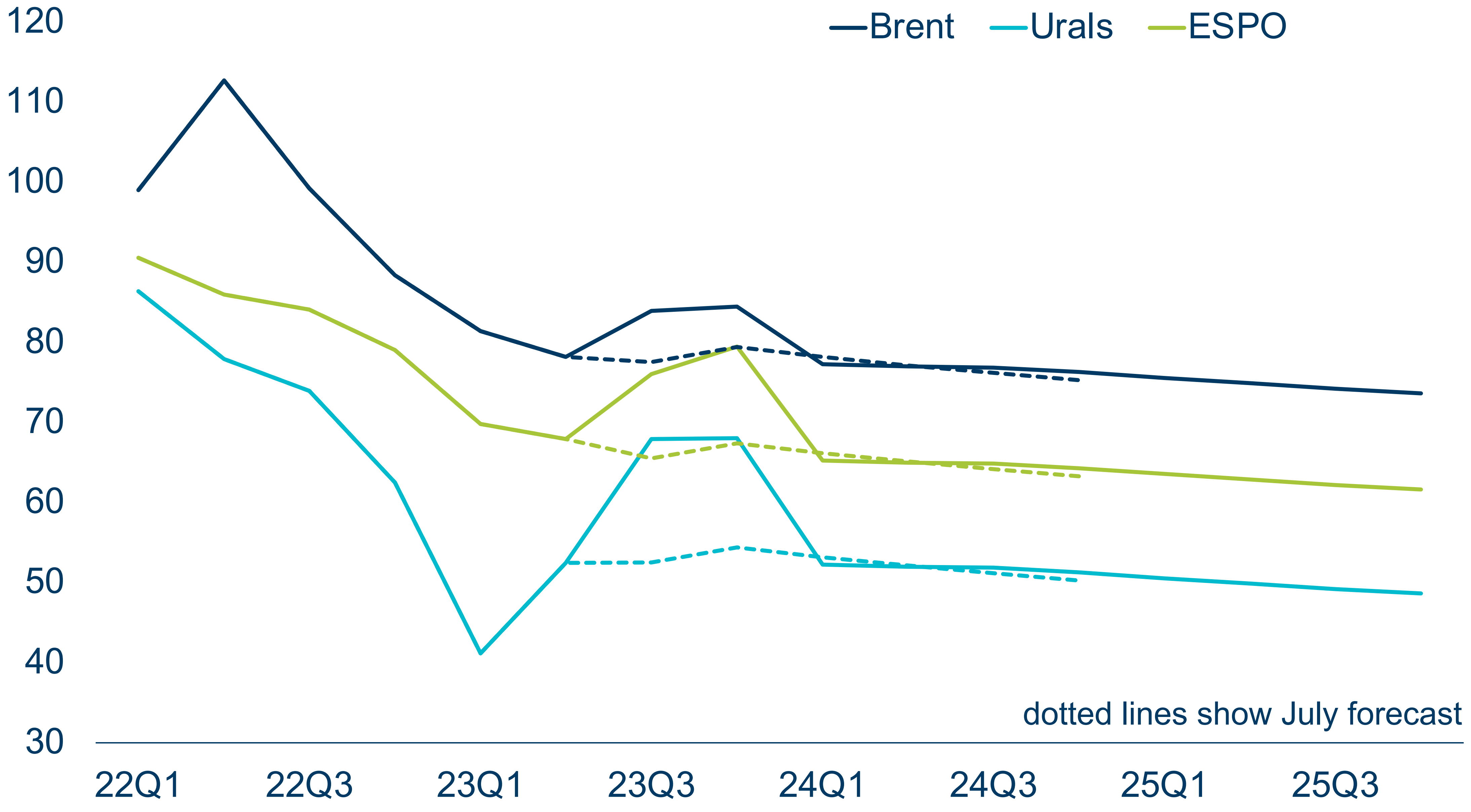
Estimate of Russian export prices and earnings revised upward.

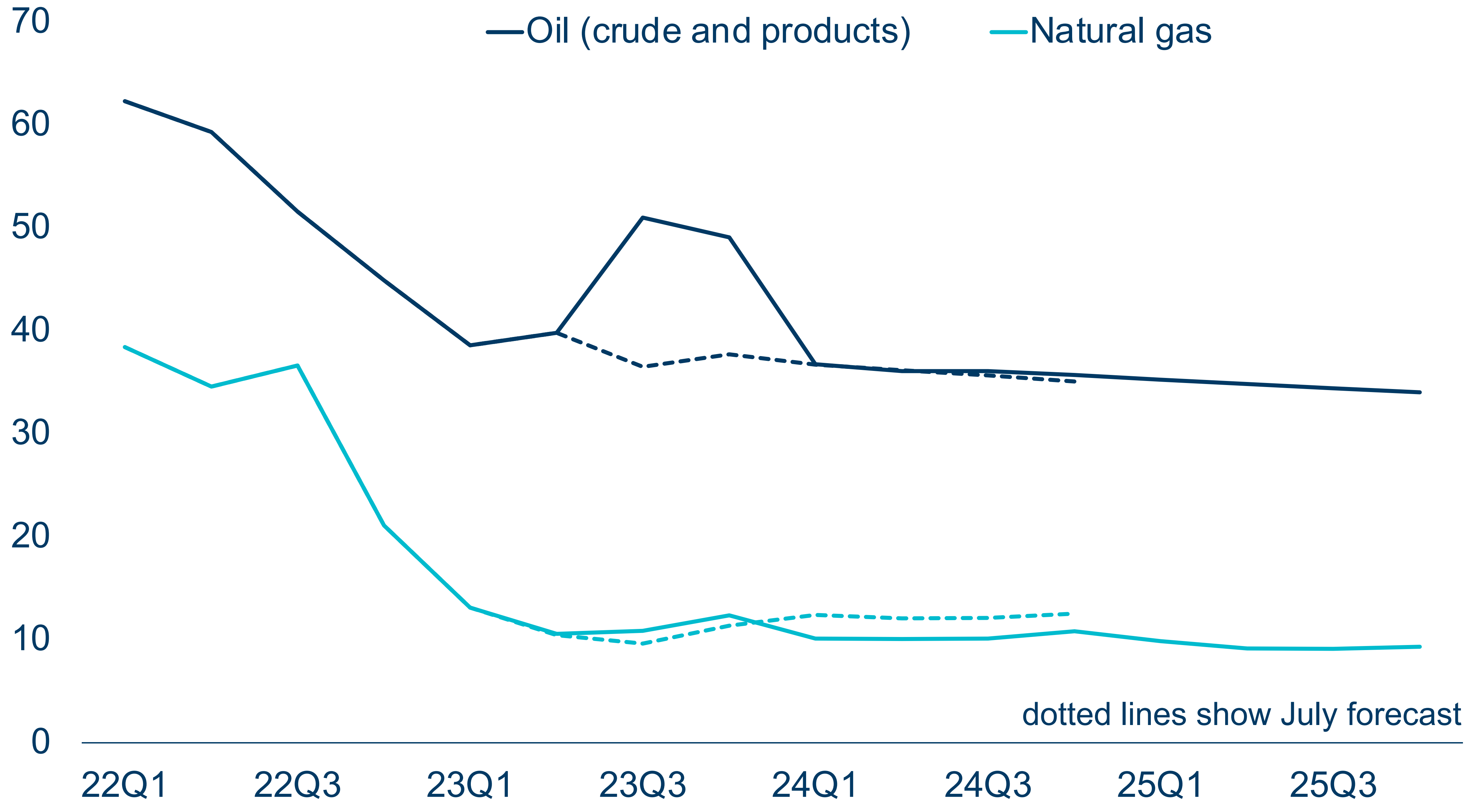
- Higher global prices and smaller discounts on Russian exports have led to significant upward revisions of oil prices.
- Importantly, our projection still assumes a moderate widening of discounts due to improved price cap enforcement.
- Nonetheless, export earnings from oil are forecast to come in $27 billion higher this year than previously expected.

Oil prices, in U.S. dollar/barrel



Source: KSE Institute

Oil and gas export earnings, in U.S. dollar billion



Source: KSE Institute

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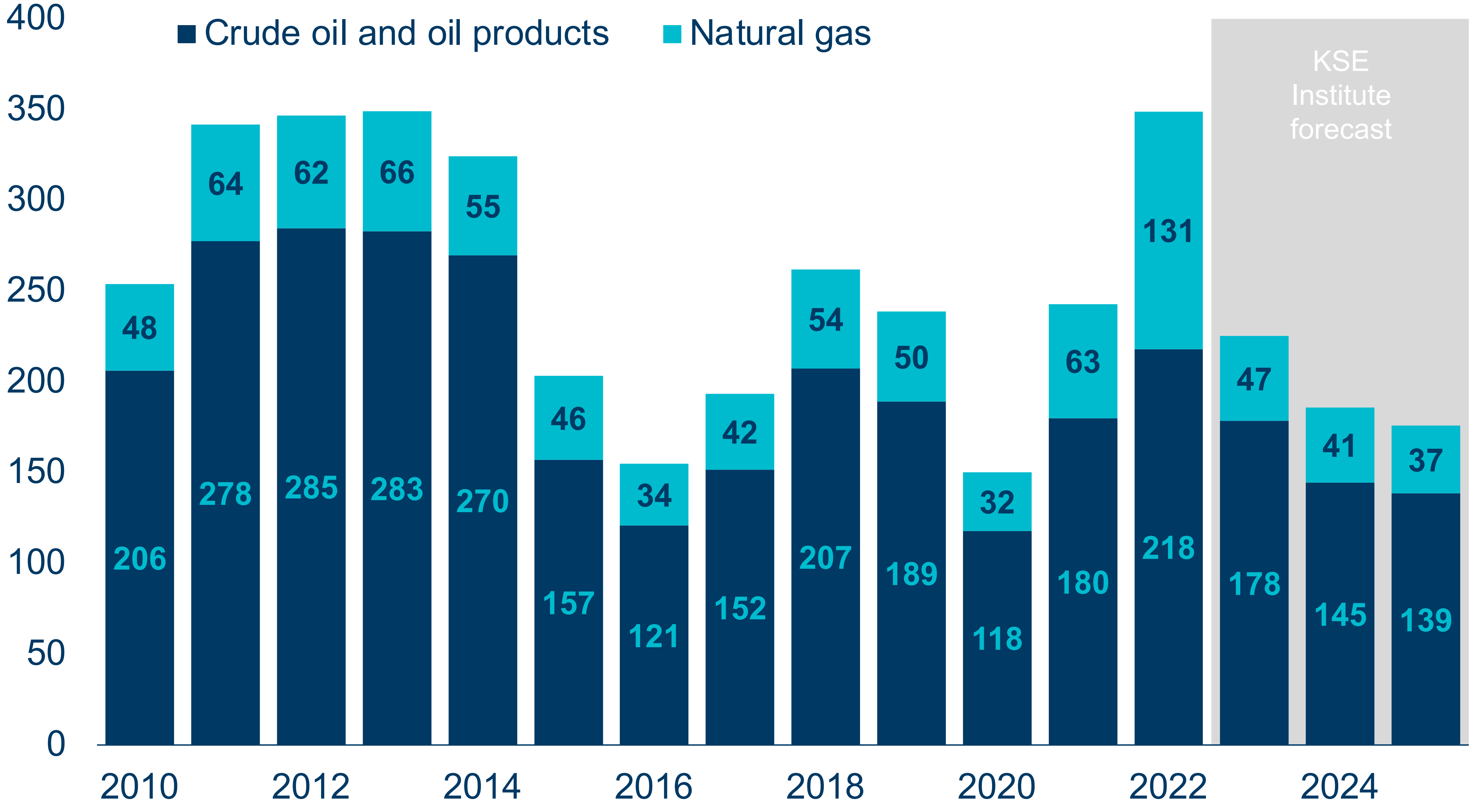
Significantly drop in the current account surplus from 2022 to 2023.

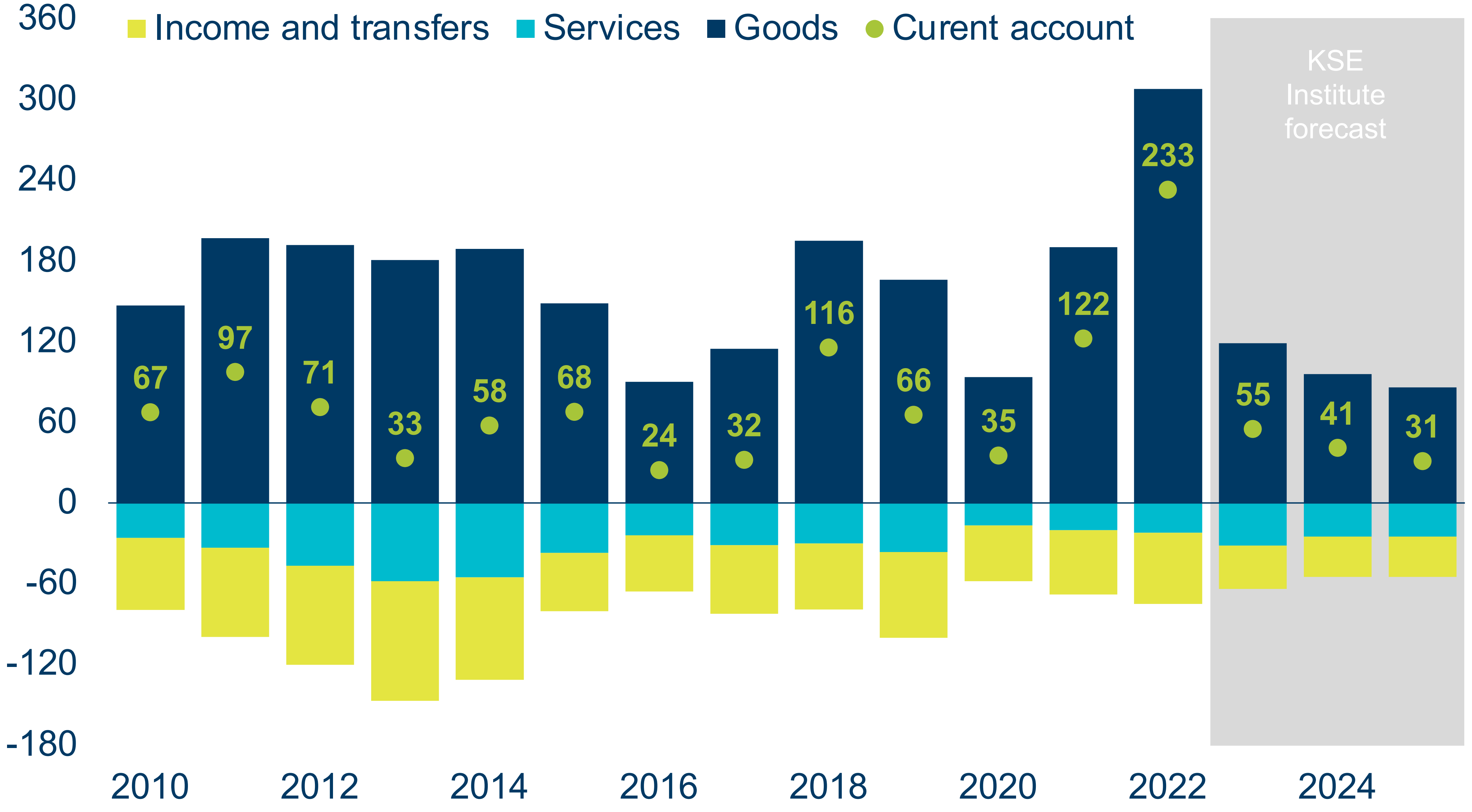
- In our updated forecast, oil and gas exports will reach $225 billion in 2023, $186 billion in 2024, and $176 billion in 2025.
- Considering the Q3 2023 outturn of current account components, we project an overall surplus of $55 billion for this year.
- Due to the high sensitivity of Russia's external balance to oil price changes, it is critical to maintain pressure from sanctions.

Oil and gas earnings, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

Current account and components, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

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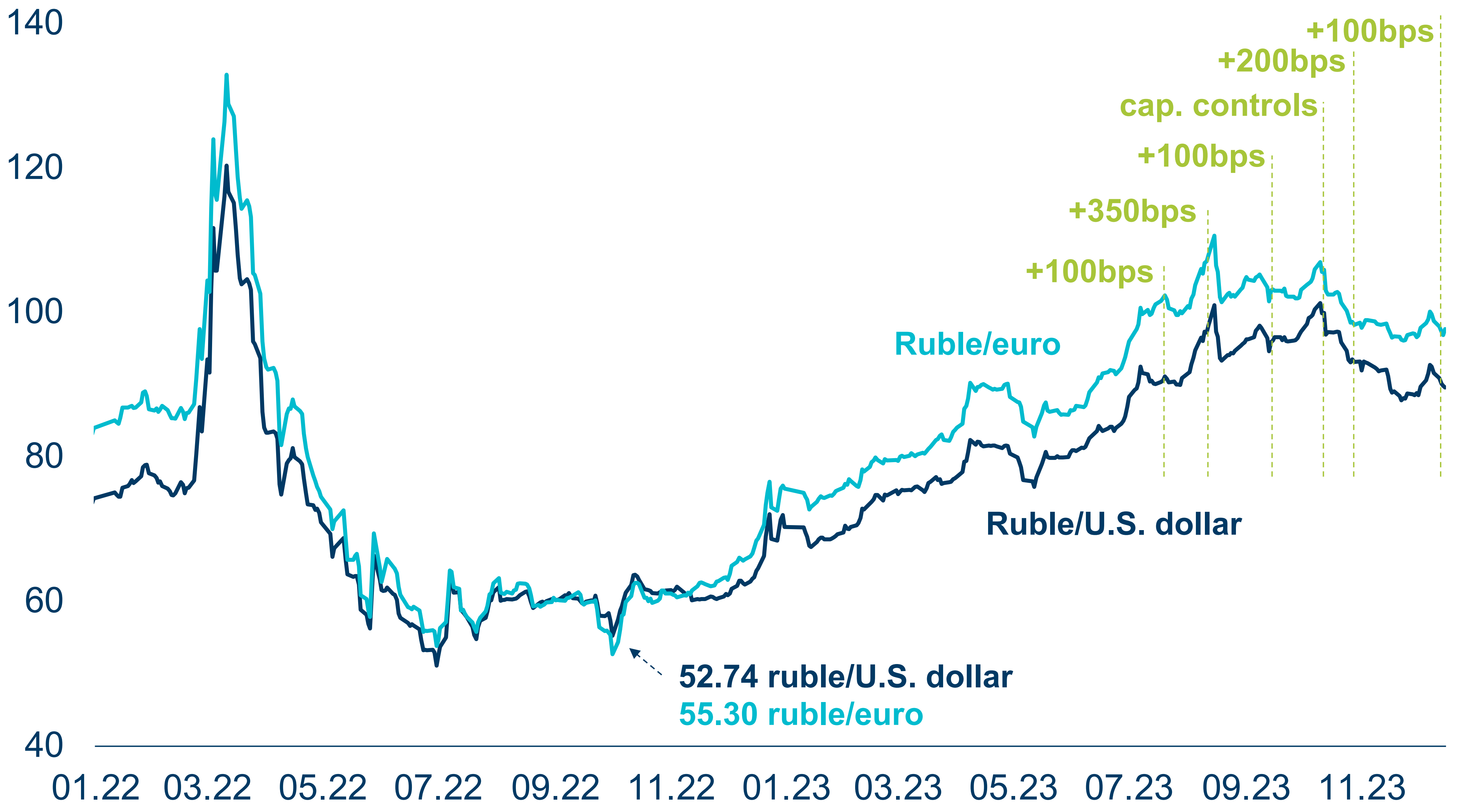
Pressure on the ruble has subsided somewhat in recent weeks.

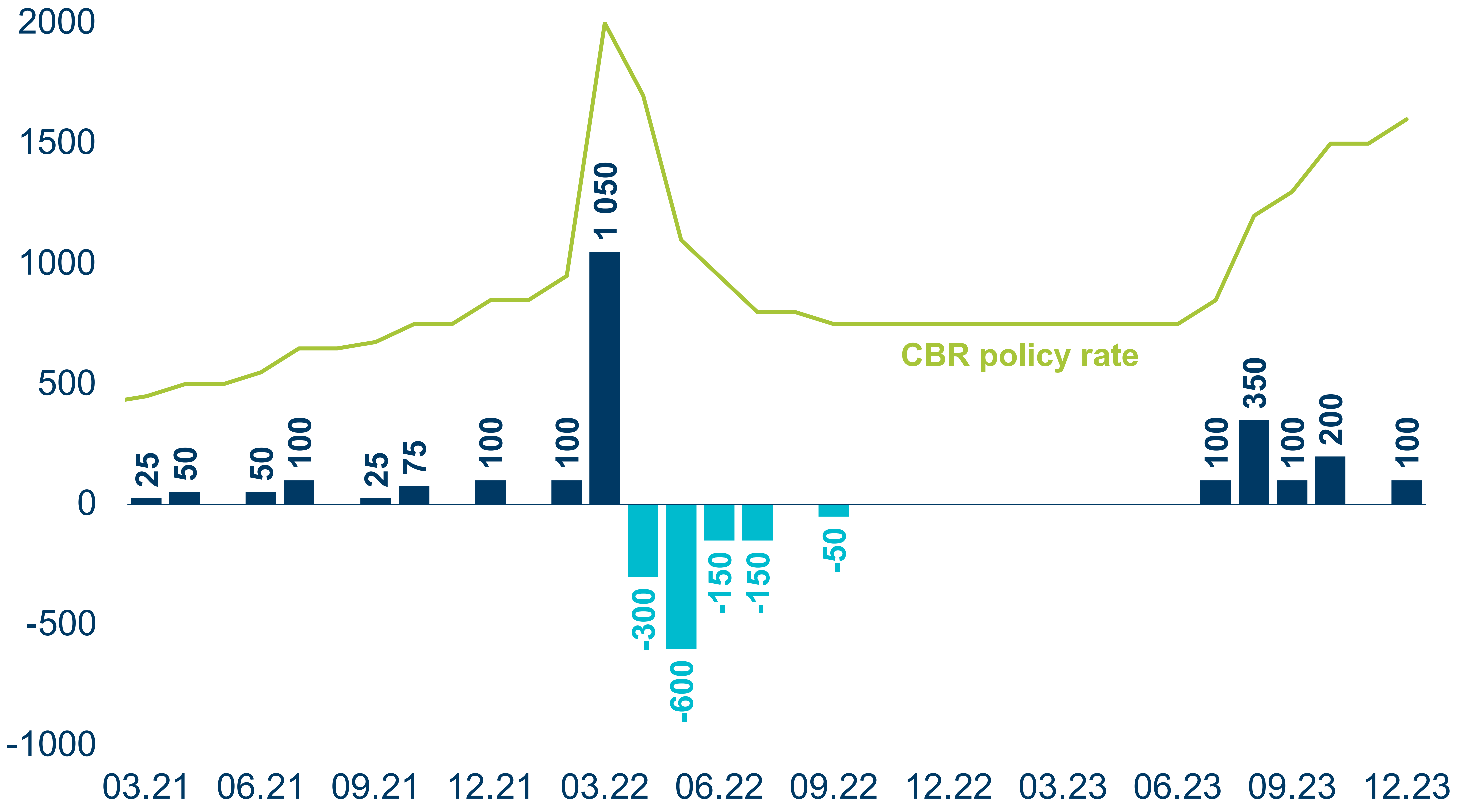
- Since October 2022, the ruble has lost ~41% of its value against the U.S. dollar and ~43% against the euro.
- The re-introduction of capital controls and additional CBR interest rate hikes have led to some stabilization.
- Clearly, the regime sees ruble stabilization and contained inflation as a key priority ahead of the 2024 elections.

Ruble exchange rate vs. U.S. dollar and euro



Source: Bank of Russia, KSE Institute

CBR policy rate and MPC decisions, in bps



Source: Bank of Russia, KSE Institute

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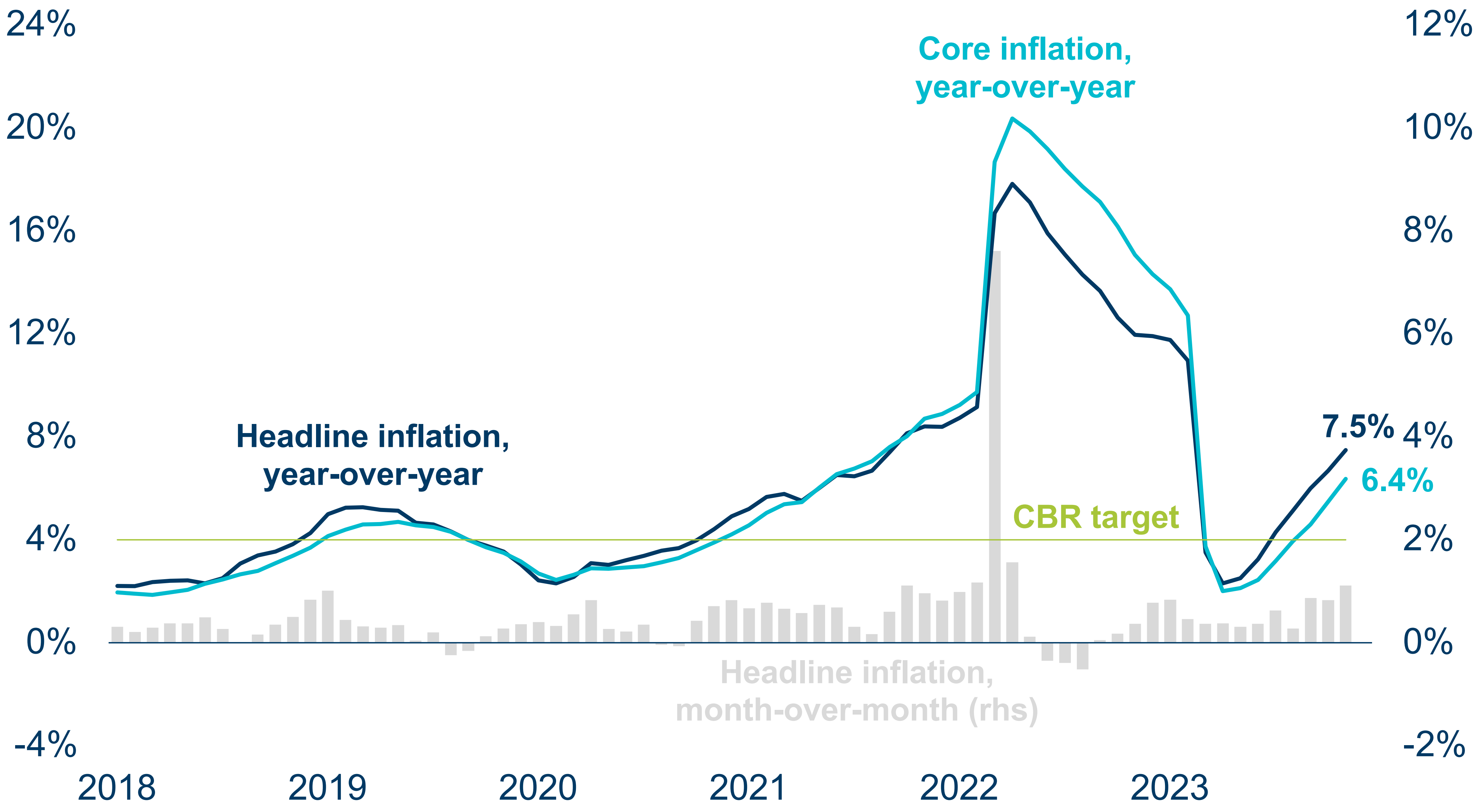
Inflation begins to pick back up as base effects fade.

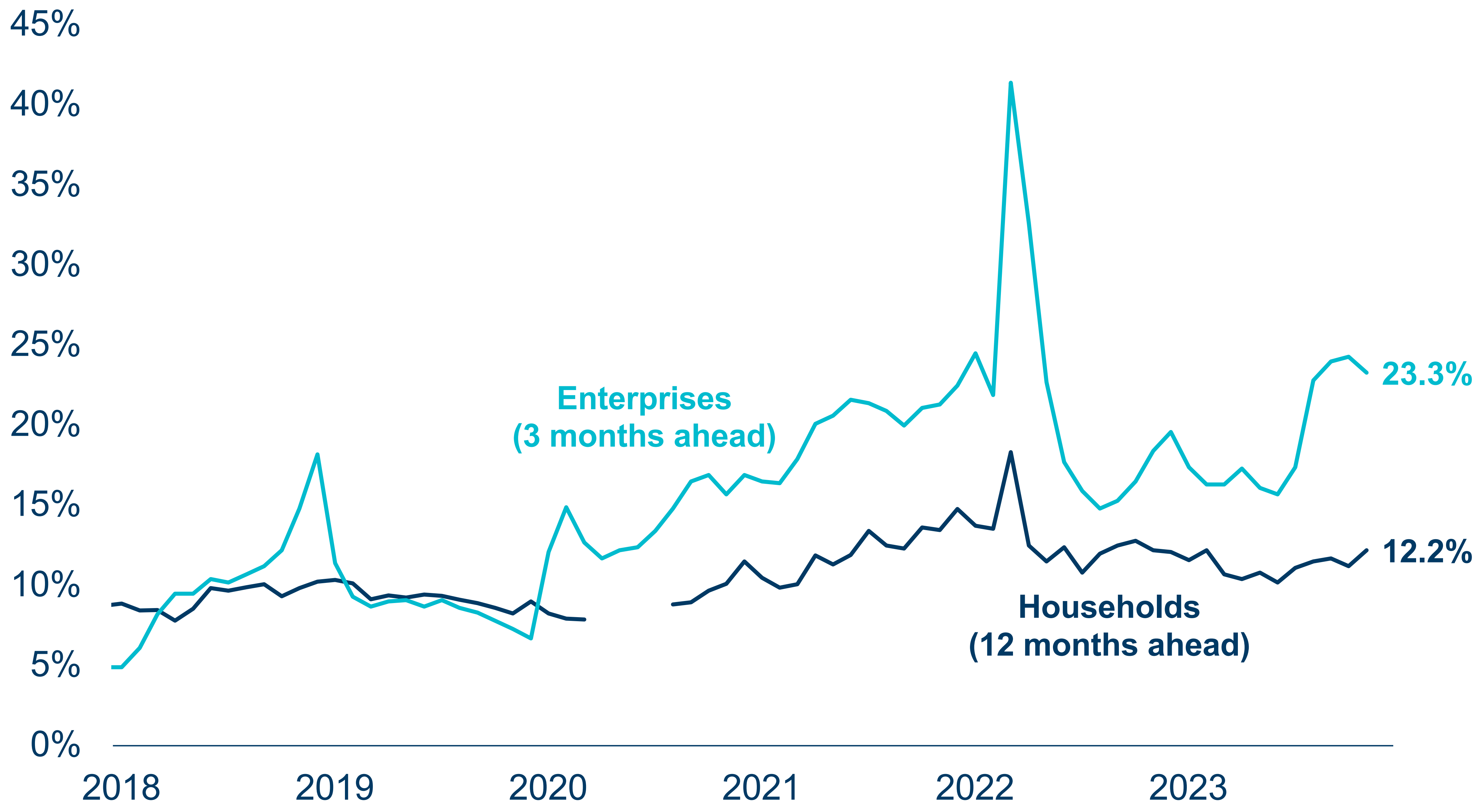
- Following a base effects-driven drop in spring/summer, both headline and core inflation are rising again.
- Based on current price dynamics, headline inflation will likely rise to around 8% by the end of the year.
- But price index based on FMCG has grown 47.9% since February 2022 (vs. ~20% of the overall CPI).

Inflation, in %



Source: Bank of Russia, KSE Institute

Inflation expectations, in %



Source: Bank of Russia, KSE Institute

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Budget: due to rising export earnings from energy and ruble weakness, fiscal situation is improving significantly.

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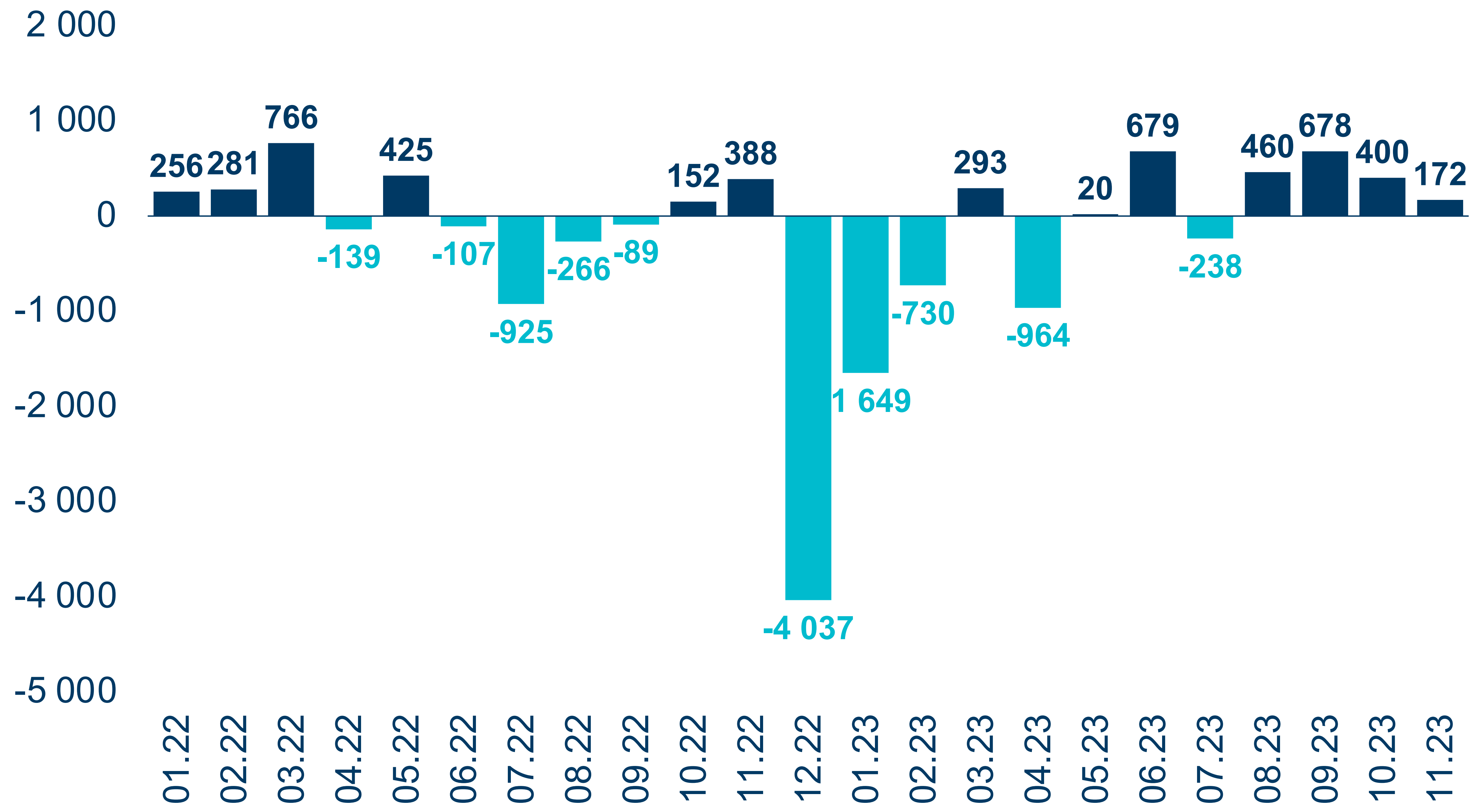
Russia's federal budget has improved markedly in recent months.

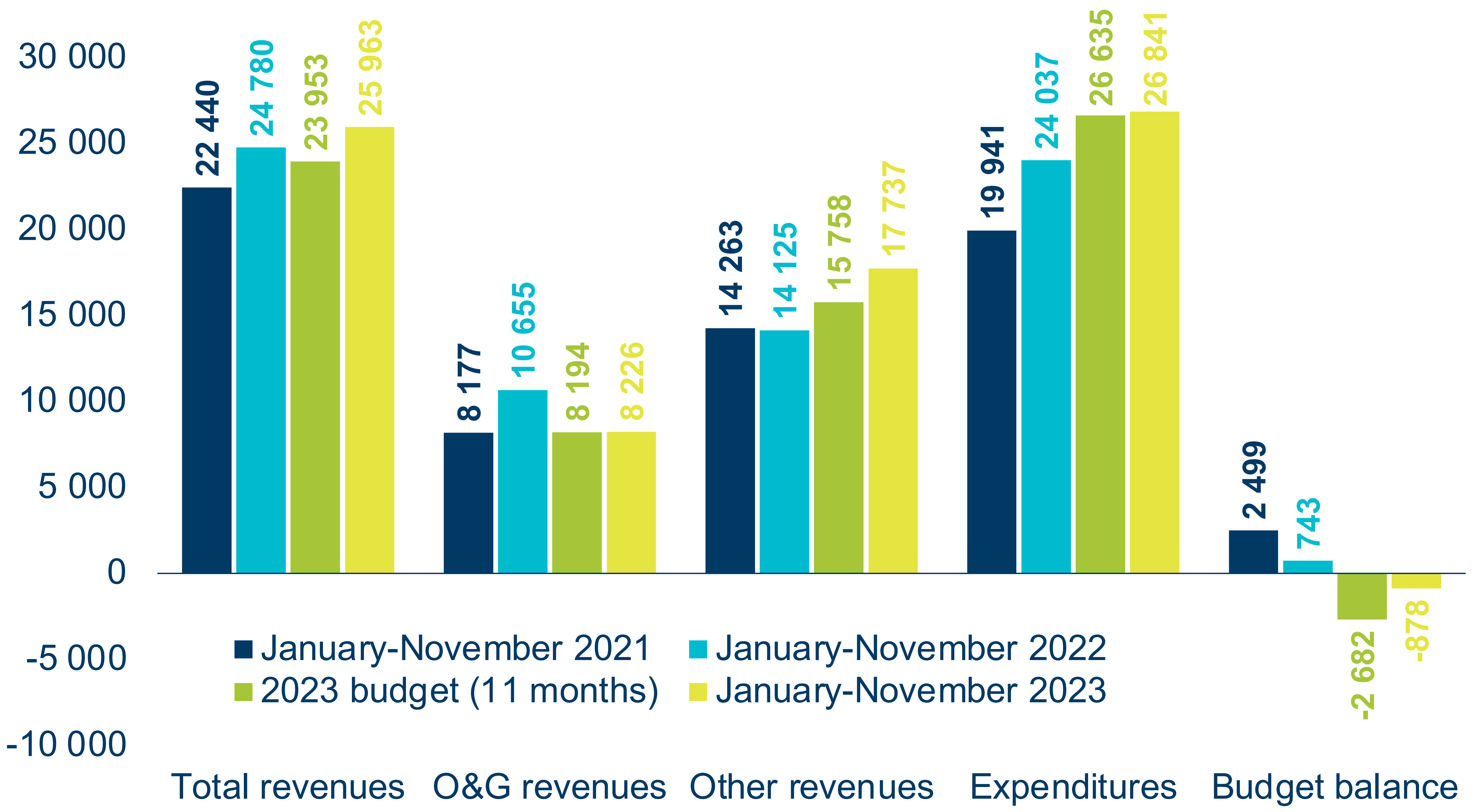
- Russia's budget reached a surplus of 1.8 trillion rubles in June-October, a marked improvement vs. January-May.
- A cumulative deficit of 0.9 trillion in January-November represents only 30% of the what was budgeted for the full year.
- Even considering the pattern of large December gaps, the deficit for 2023 will likely be contained at ~1% of GDP.

Federal government balance, in ruble billion



Source: Ministry of Finance, KSE Institute

Revenues and expenditures, in ruble billion



Source: Ministry of Finance, KSE Institute

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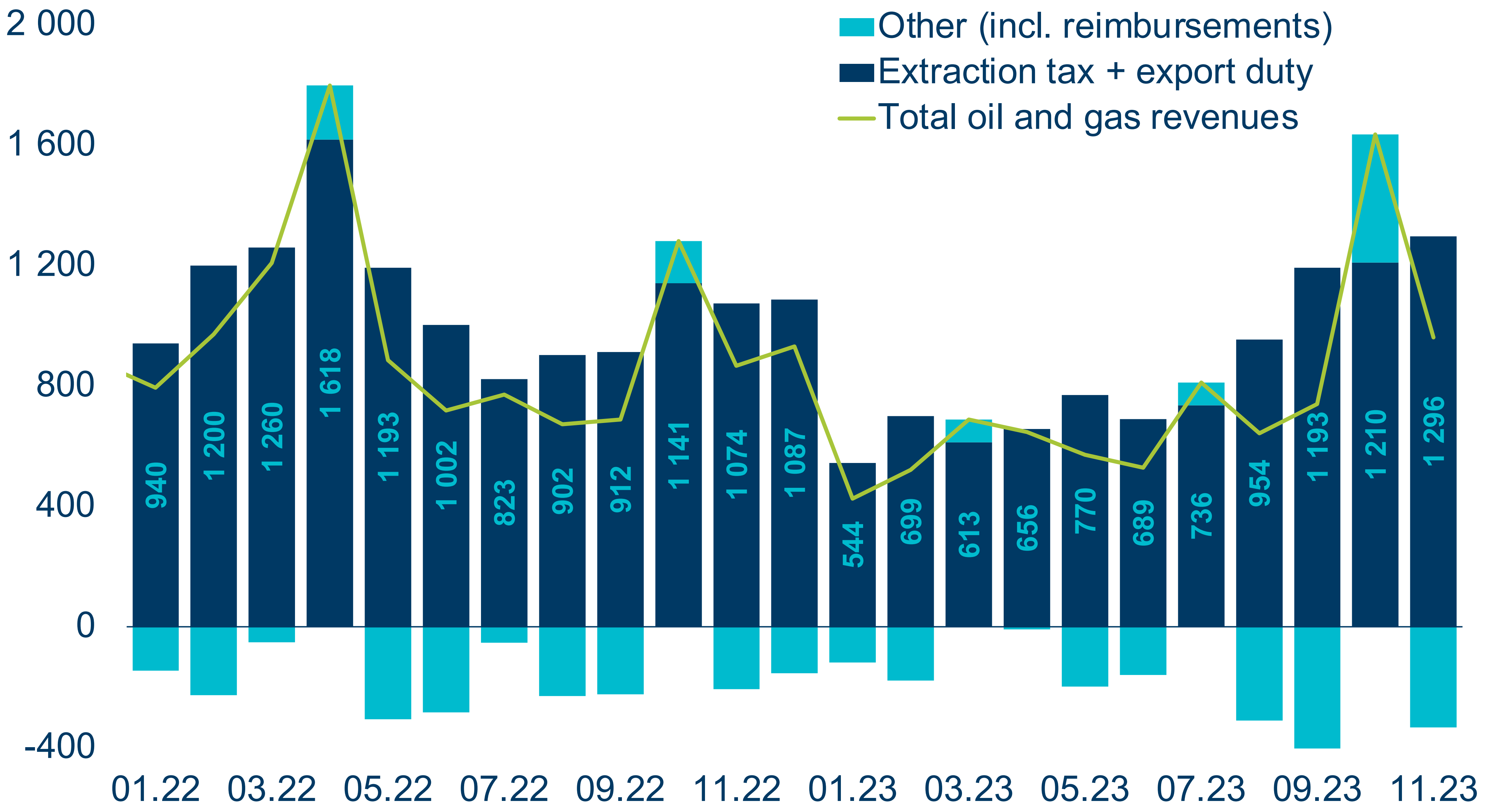
Oil and gas revenues are benefitting from higher prices, weaker ruble.

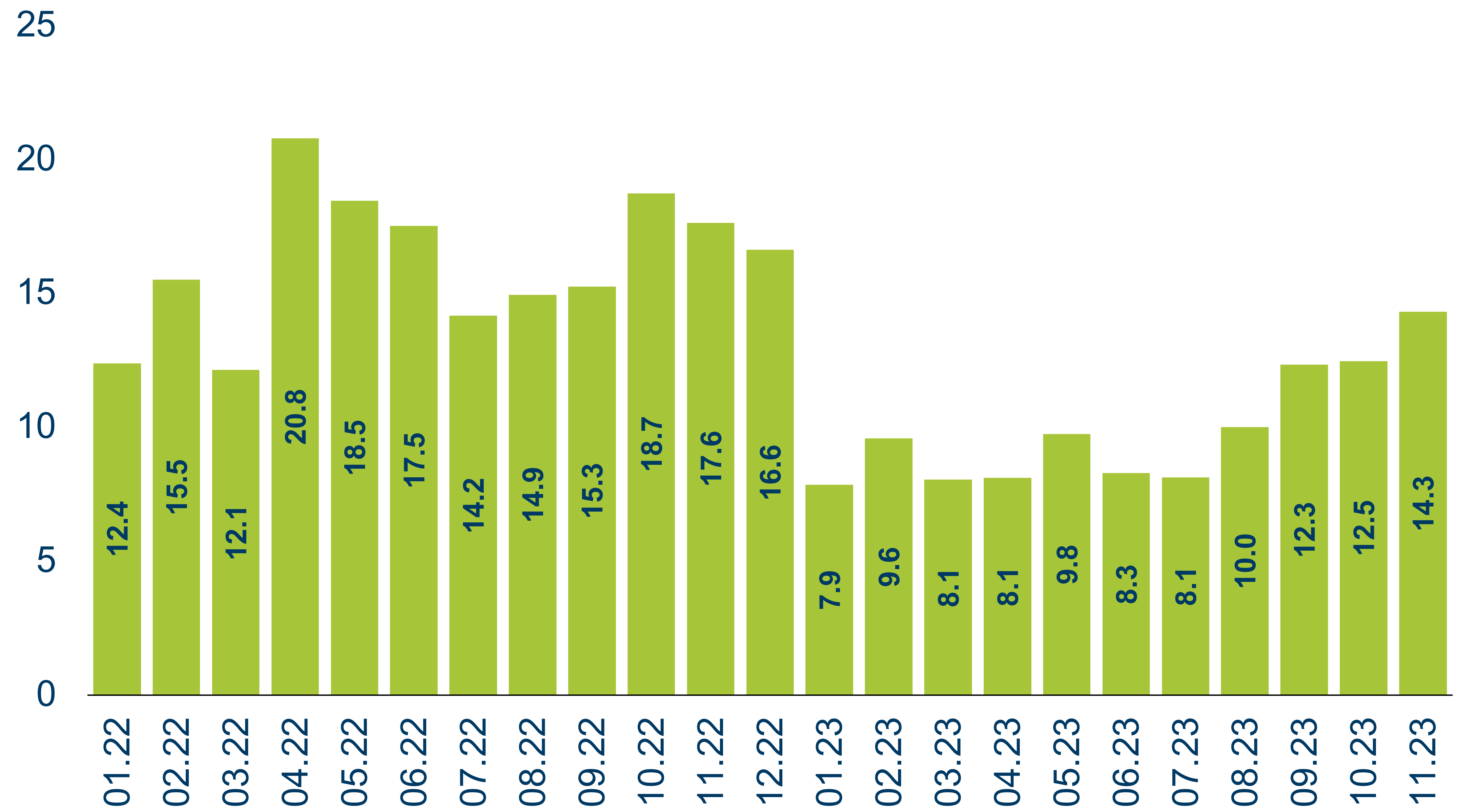
- Extraction taxes and export duties reached around 1.3 trillion rubles in September, the highest since April 2022.
- While the budget benefits from the weaker ruble, oil and gas revenues in U.S. dollar terms are also rising.
- The narrowing of Urals-Brent spreads means that changes to the tax oil price have not had a big effect yet.

Federal oil and gas revenues, in ruble billion



Source: Ministry of Finance, KSE Institute

Federal oil and gas revenues, in U.S. dollar billion*



Source: International Monetary Fund, Ministry of Finance, KSE Institute
*includes extraction tax and export duty; calculated with monthly average exchange rate

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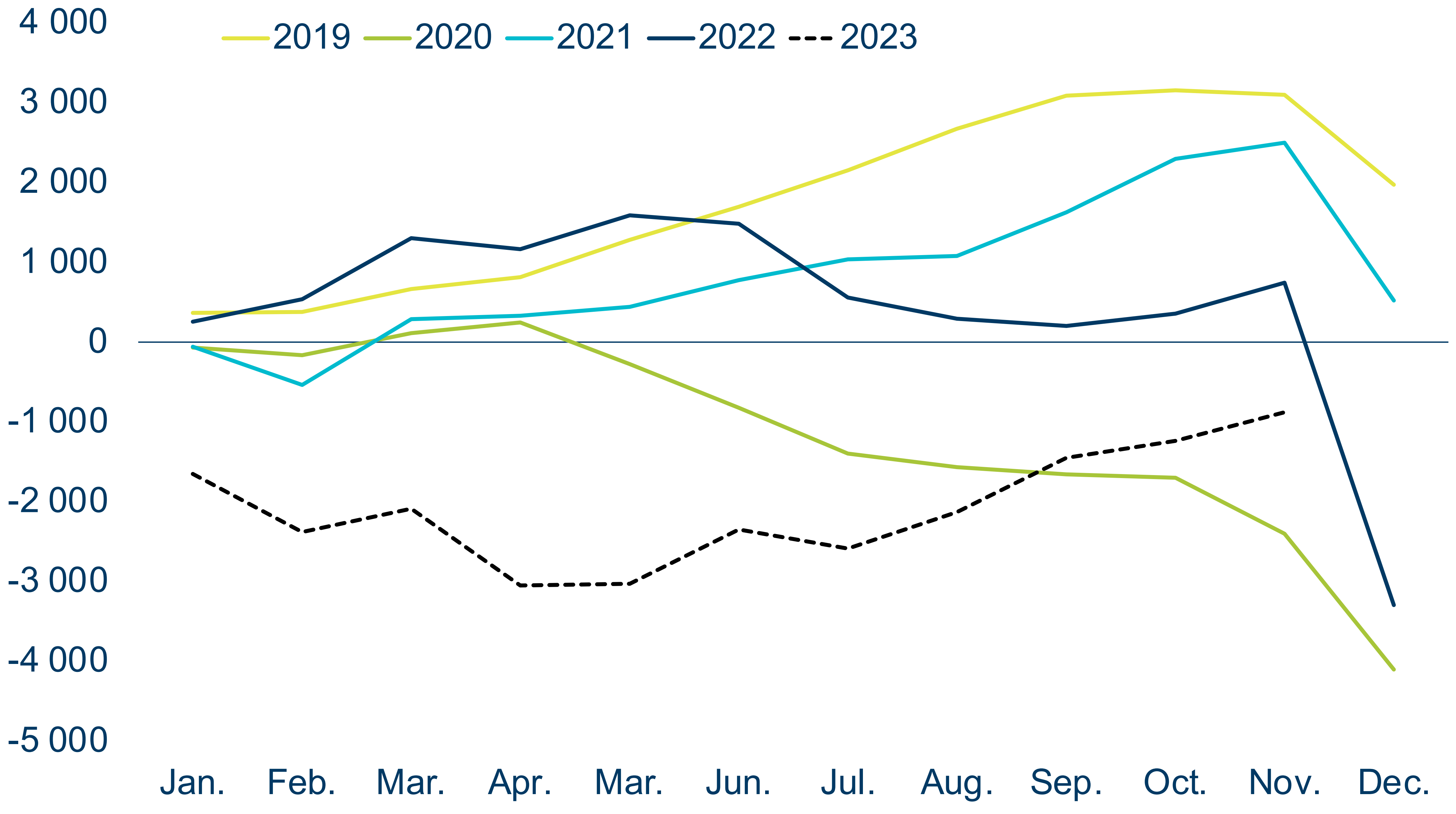
Reliance on NWF and OFZ issuance remains low.

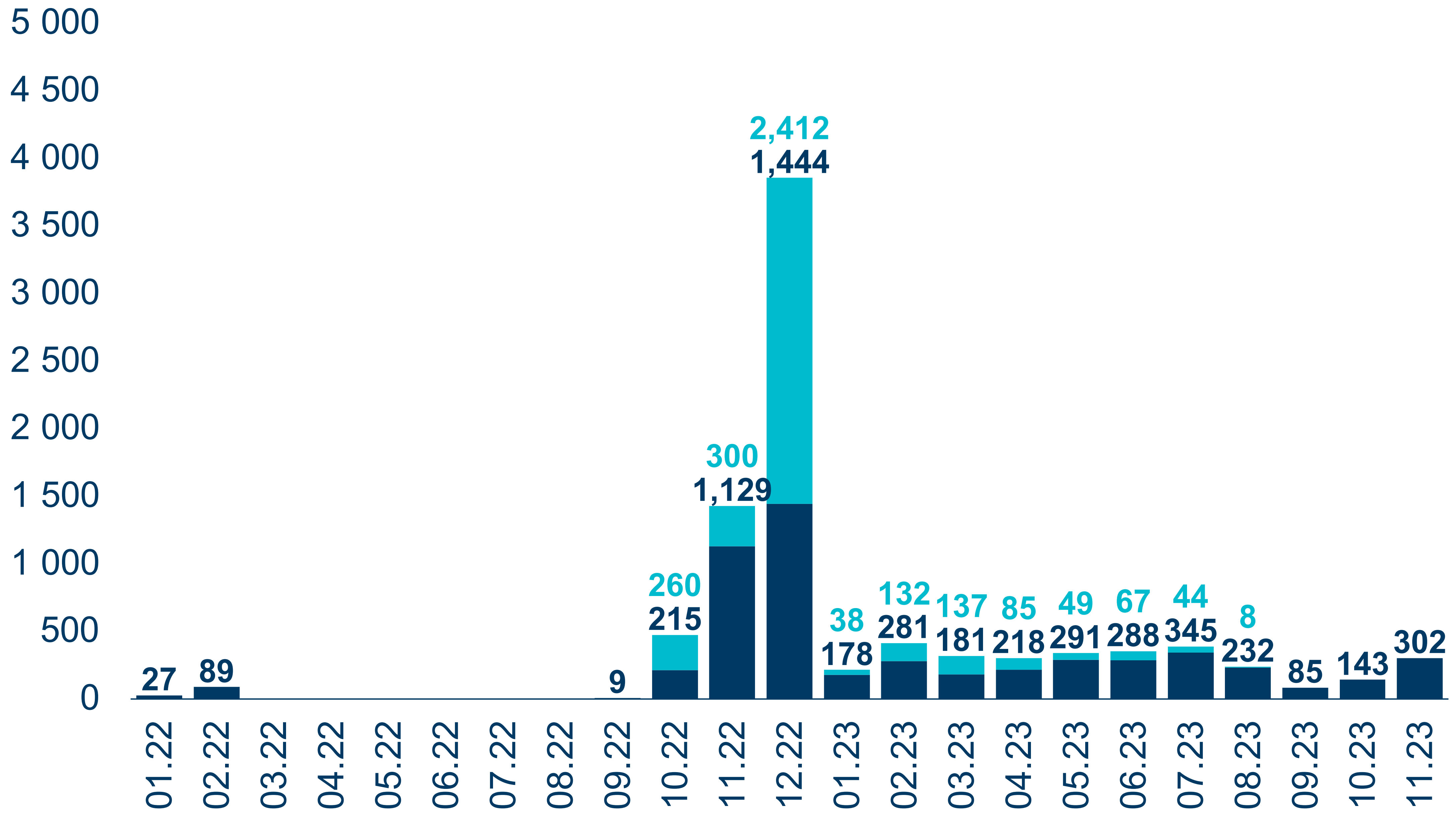
- Due to the shrinking deficit, Russia decreased reliance on key financing channels—NWF withdrawals and OFZ issuance.
- New issuance of domestic debt (OFZ) was 2.4 trillion rubles in January-November 2023, less than in Q4 2022 alone.
- At the same time, the NWF only sold assets worth 560 billion rubles to support the budget (vs. 3 trillion in Q4 2022).

Cumulative federal budget balance, in ruble billion



Source: Ministry of Finance, KSE Institute

Key fiscal financing channels, in ruble billion



Source: Ministry of Finance, KSE Institute

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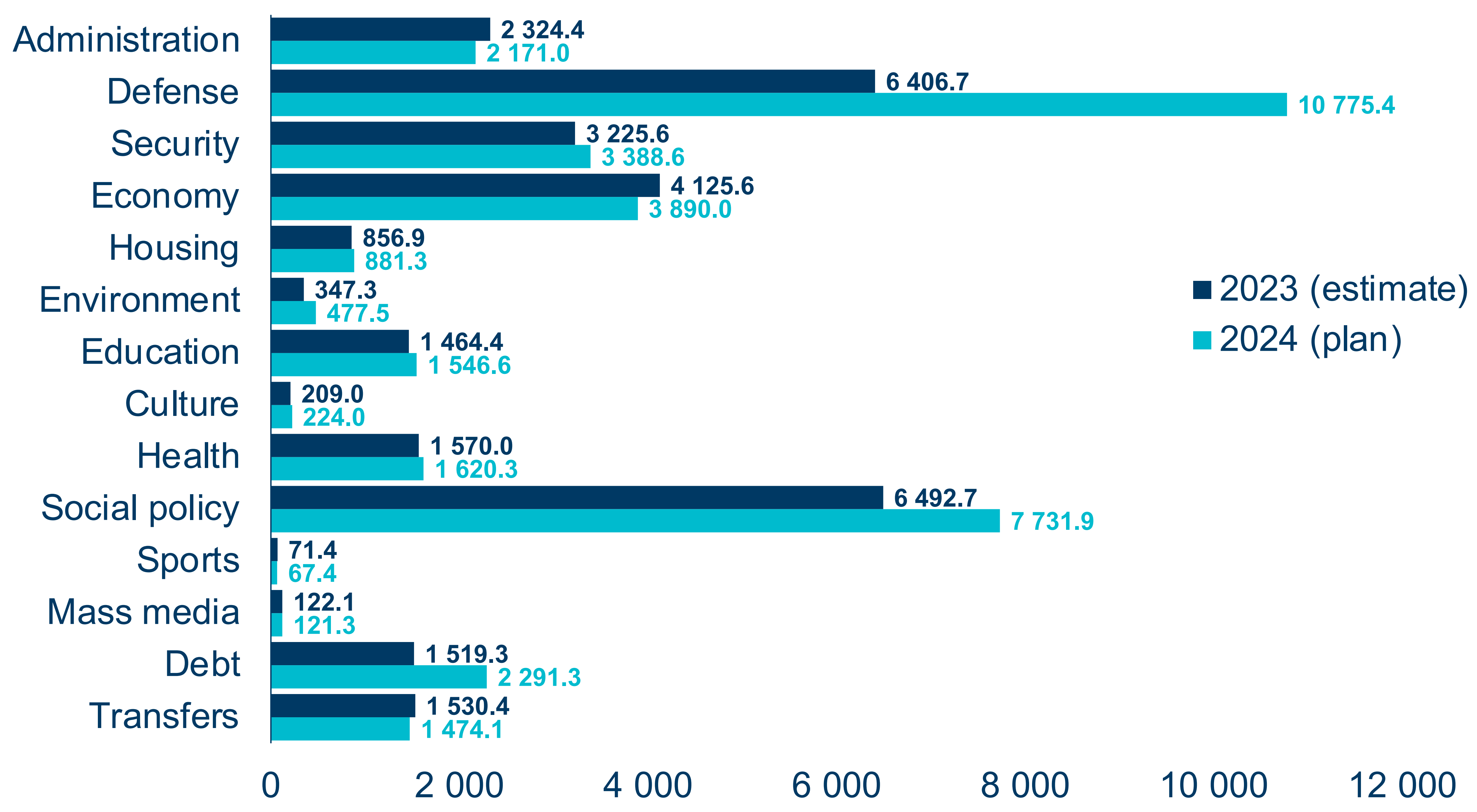
Significant increase in defense budget planned for 2024.

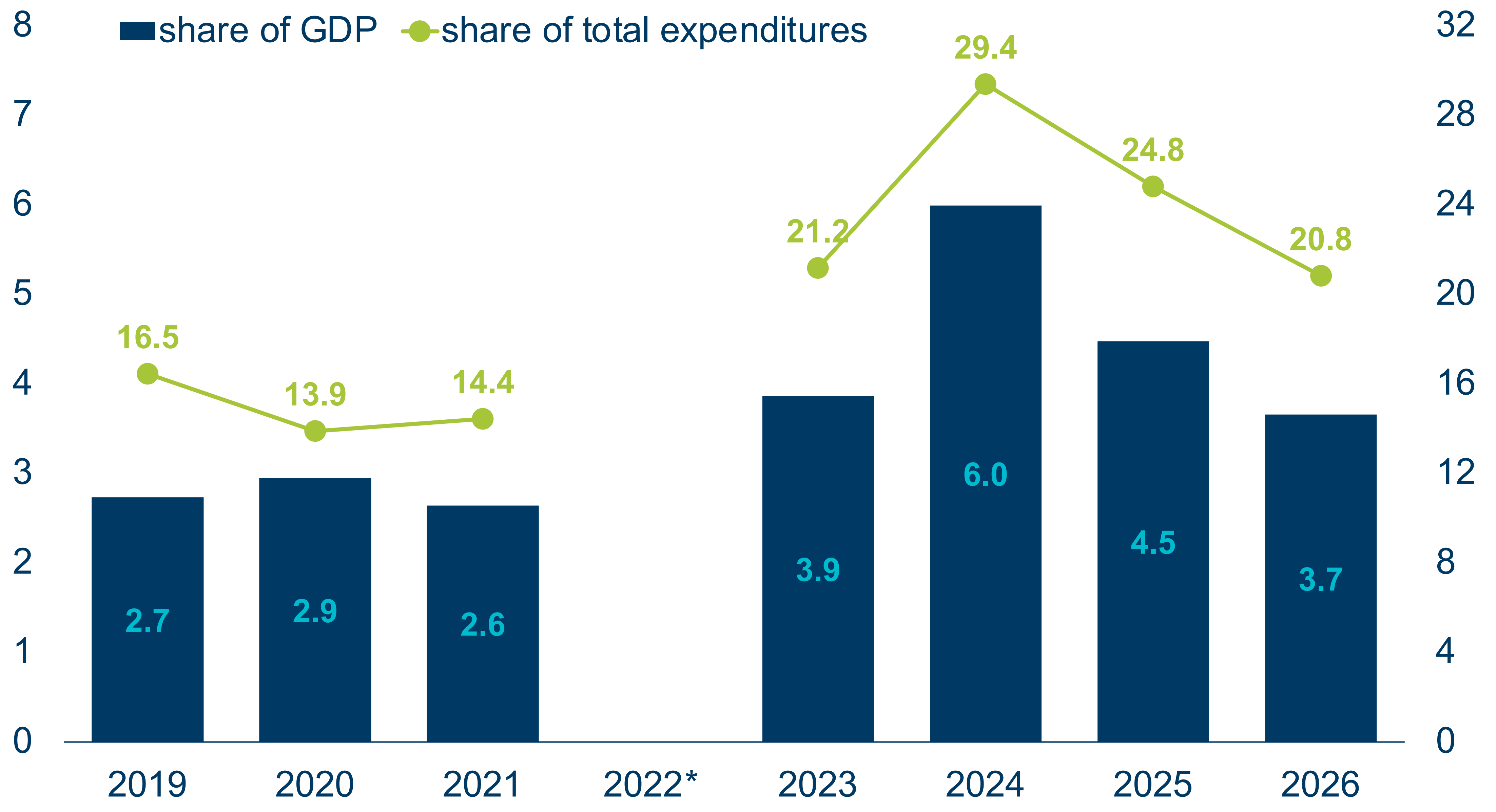
- The Russian government plans to spend 10.7 trillion rubles (~$100 billion) on defense in 2024 (+68% vs. this year).
- At 6% of GDP and close to 30% of the total federal budget, defense clearly dominates government expenditures.
- This demonstrates the regime's commitment to the war but also illustrates the extent of the military-driven stimulus.

Federal budget expenditure details, in ruble billion



Source: Ministry of Finance, KSE Institute

Federal defense expenditures, in %



Source: Ministry of Finance, KSE Institute *no expenditure breakdown published

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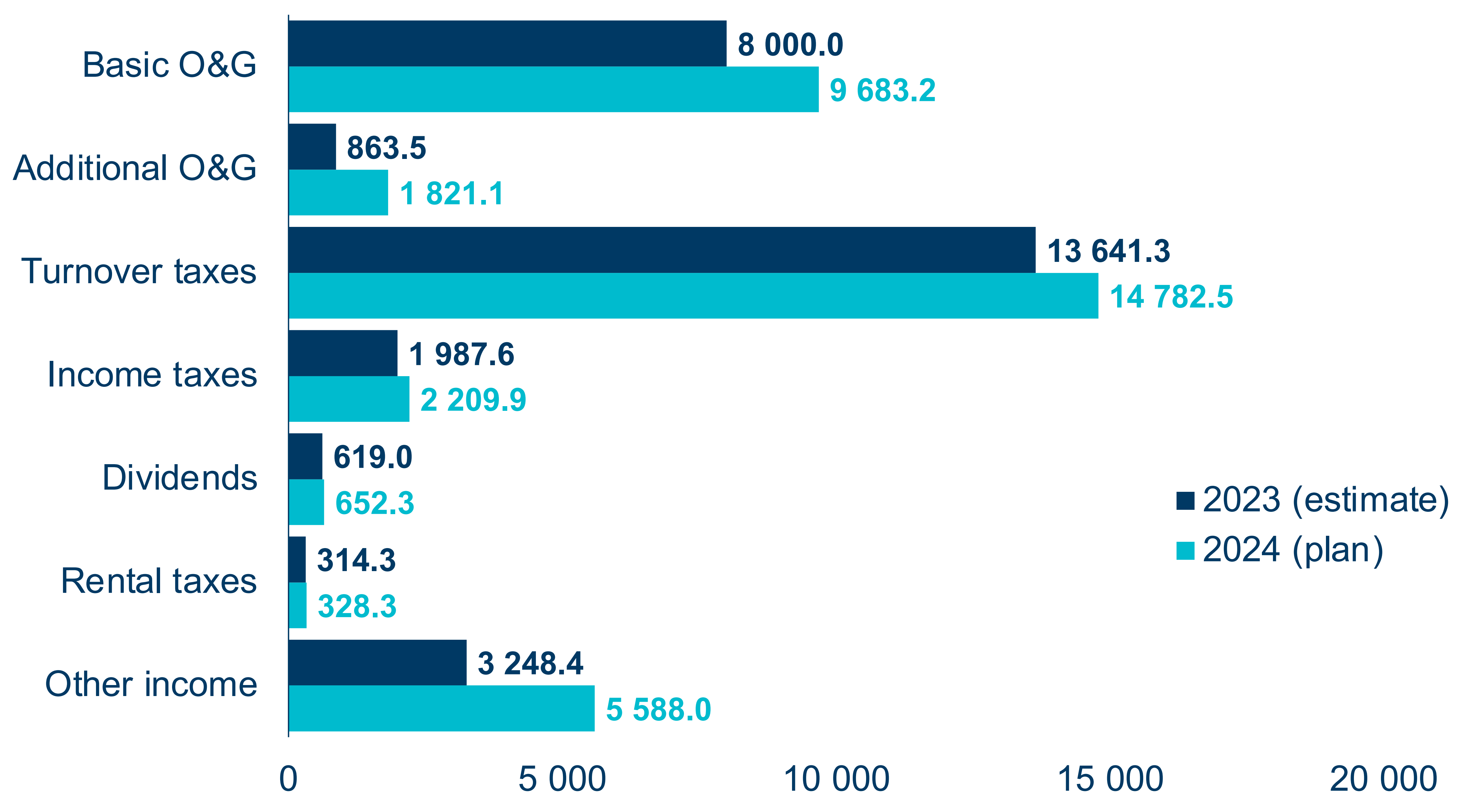
Expectation of moderate deficits in the coming years.

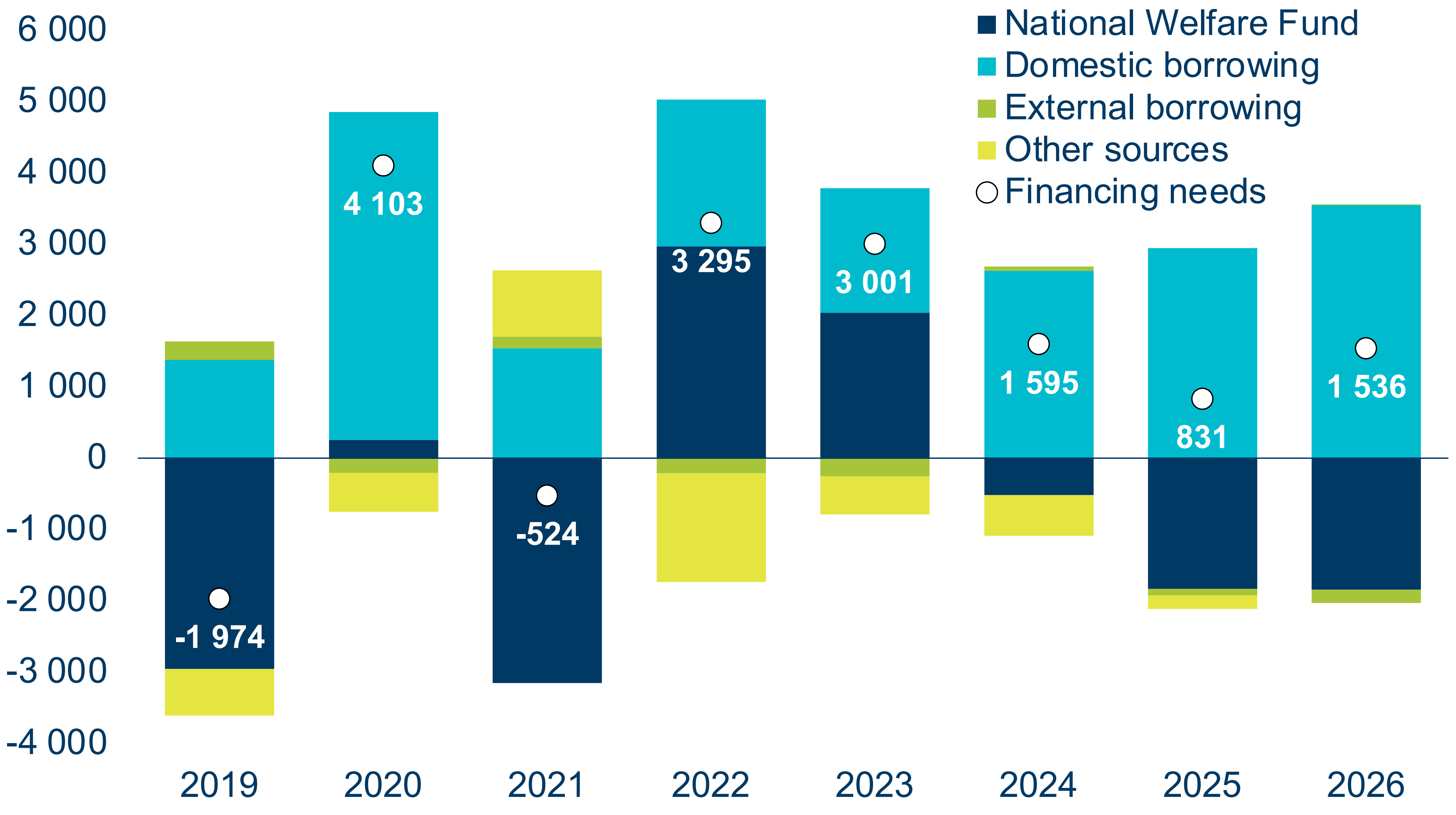
- Russia's Ministry of Finance expects revenue growth of 22% in 2024, driven by oil & gas revenues and turnover taxes.
- The federal budget deficit is projected to be at or below 1% of GDP in 2024-26 and to be financed by domestic borrowing.
- Planned net issuance is 3 trillion rubles this year, followed by 1.6 trillion, 0.8 trillion, and 1.5 trillion in 2024-26, respectively.

Federal budget revenue details, in ruble billion



Source: Ministry of Finance, KSE Institute

Federal budget financing, in ruble billion



Source: Ministry of Finance, KSE Institute

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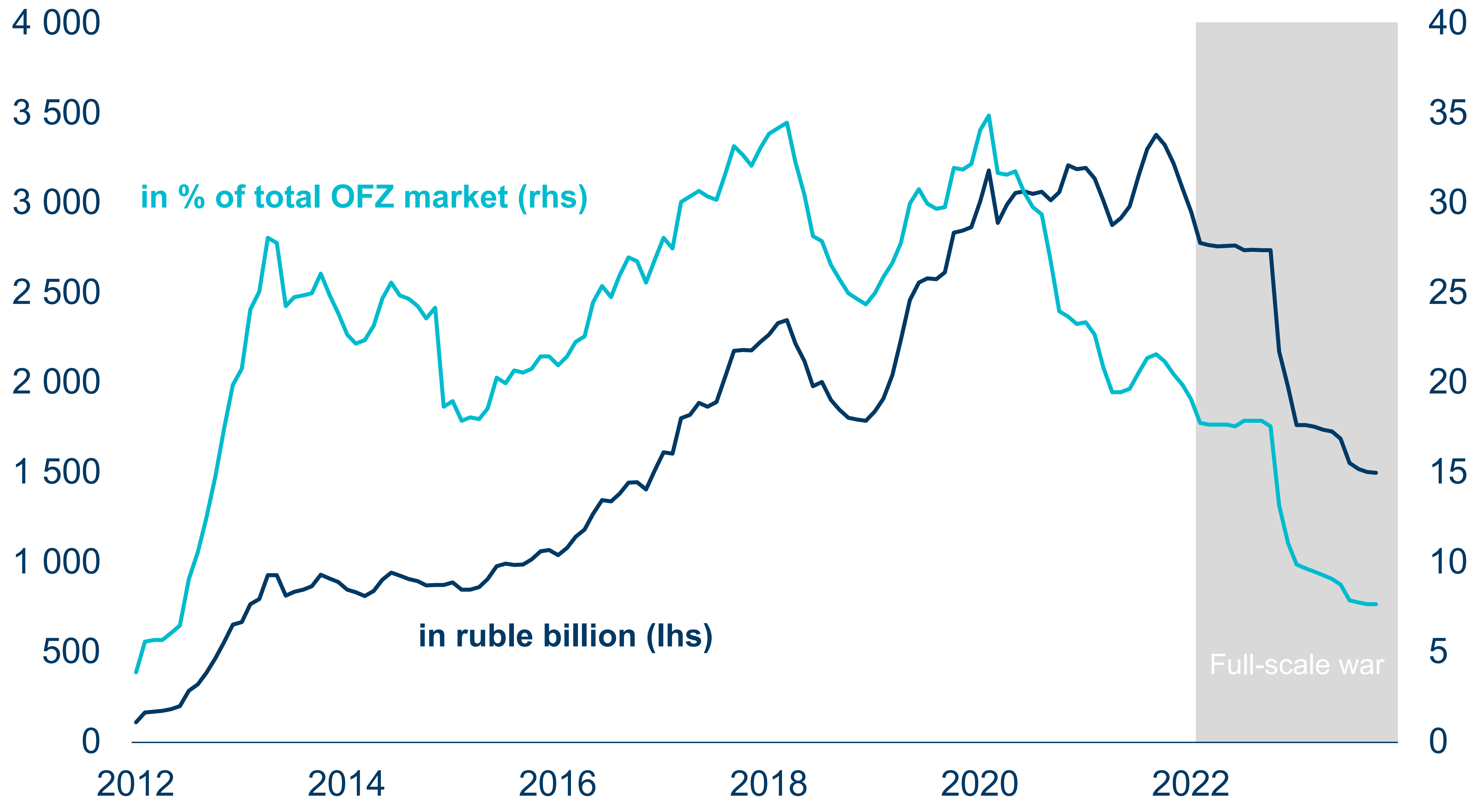
Domestic banks are the only remaining buyer for OFZs.

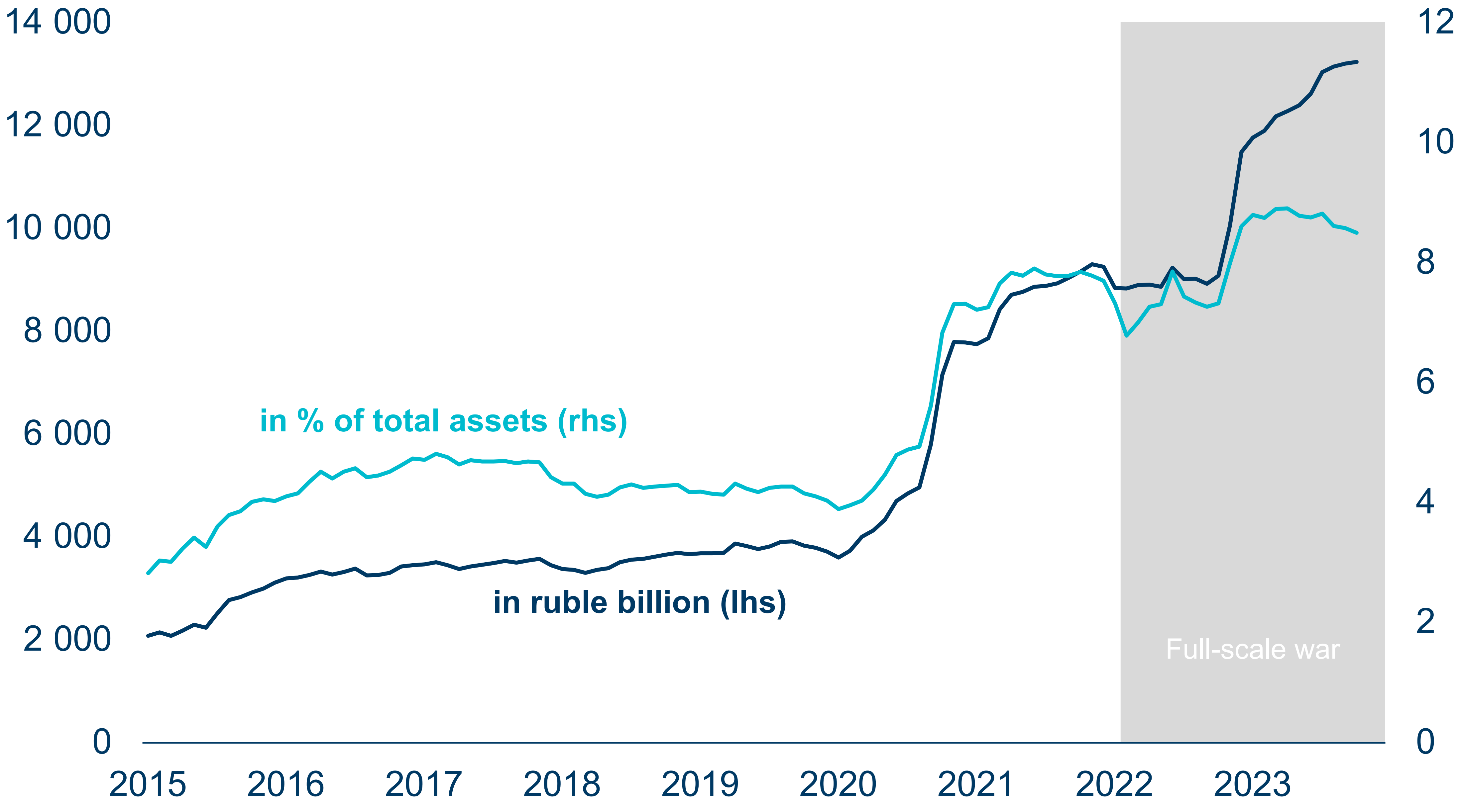
- Foreigners have largely disengaged from the Russian sovereign debt market since the start of the war.
- Non-resident holdings have dropped 1.2 trillion rubles (or 45%) since October 2022 as bonds matured.
- Over the same period, credit institutions’ holdings have risen by close to 4.2 trillion rubles (or 46%).

Non-resident OFZ holdings



Source: Bank of Russia, KSE Institute

Credit institutions OFZ holdings

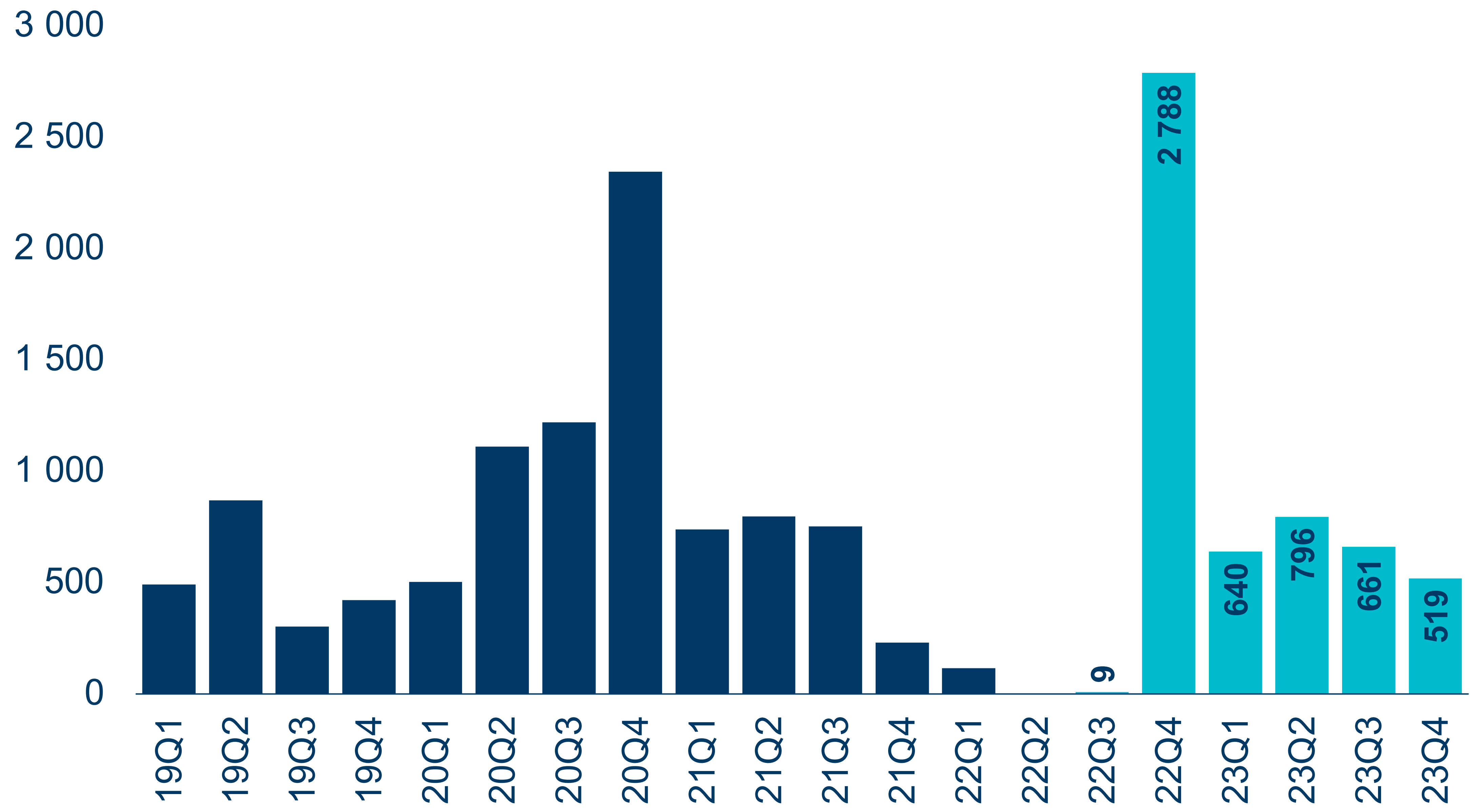


Source: Bank of Russia, KSE Institute

The cost of borrowing has been rising since early-2022.

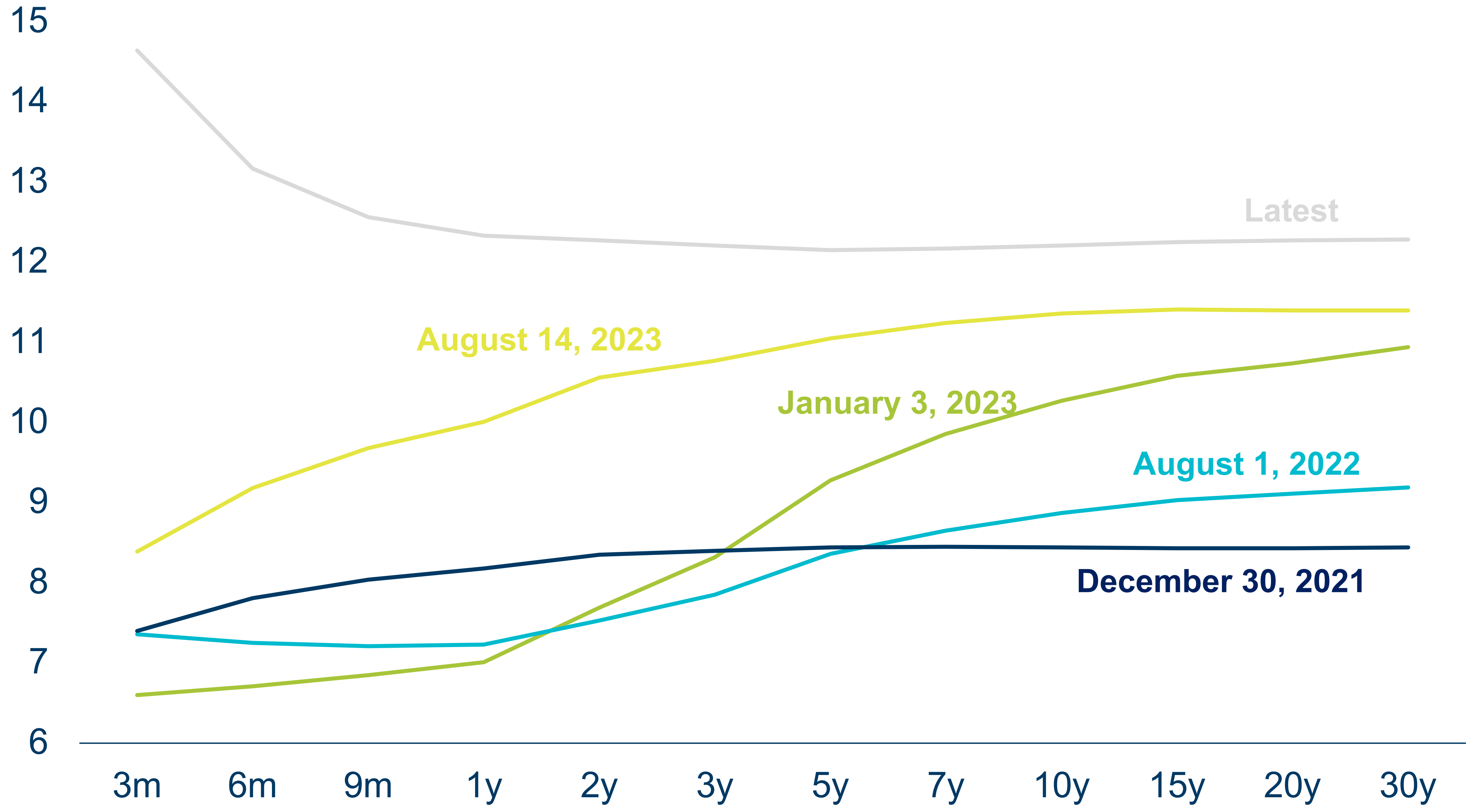
- Due to the improved fiscal picture, we do not expect a significant increase in auction volumes for the rest of 2023.
- The OFZ yield curve reflects the recent CBR rate hikes (of cumulative 850bps) with the short end shifting up sharply.
- Longer maturity interest rates will inevitably follow suit in the coming weeks/months, driving up overall borrowing costs.

New domestic debt (OFZ) issuance, in ruble billion



Source: Ministry of Finance, KSE Institute

OFZ yield curves, in %



Source: Bank of Russia, KSE Institute

Macro buffers: NWF benefits from improved fiscal picture, access to reserves seriously constrained

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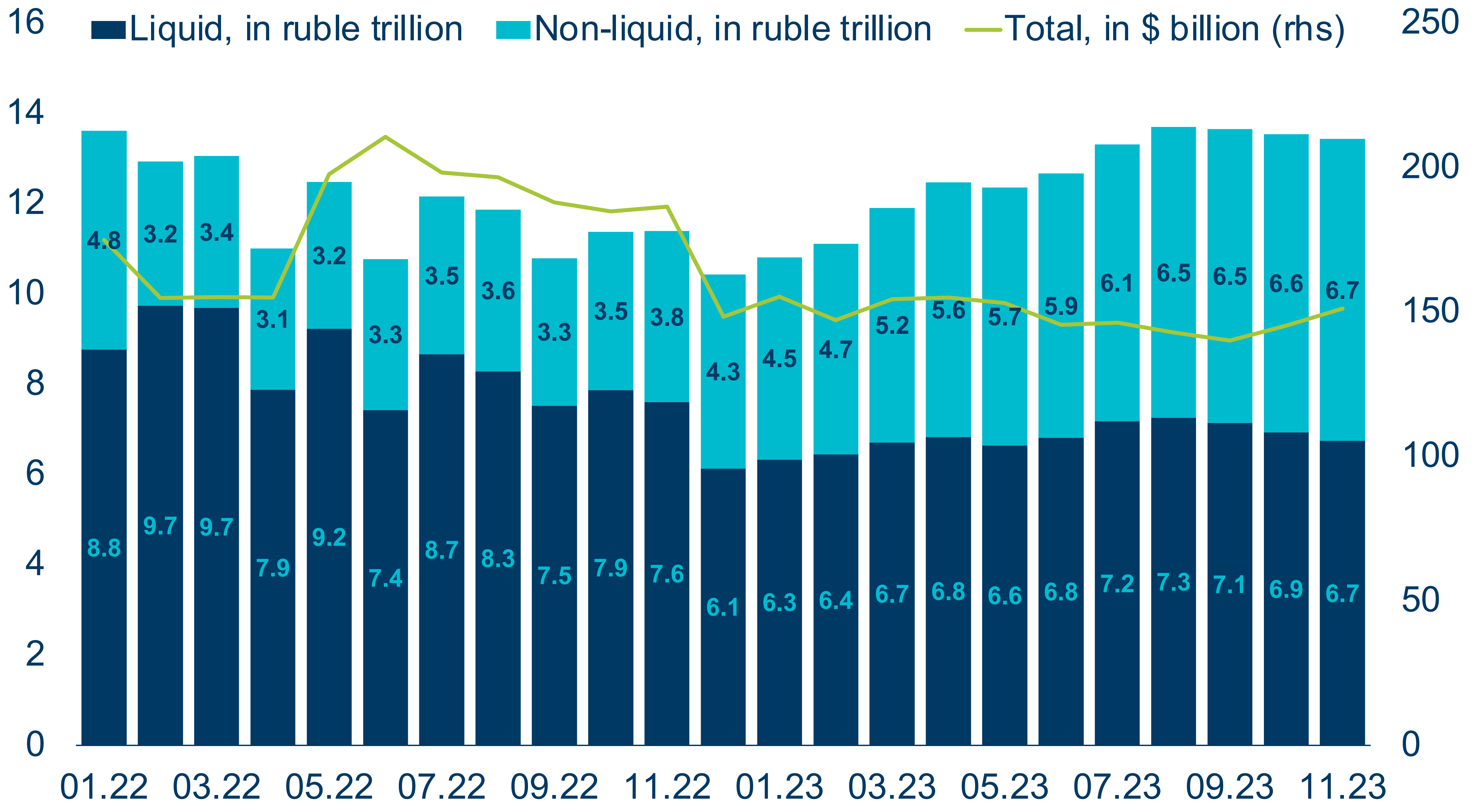
NWF assets have risen due to smaller withdrawals, valuation effects.

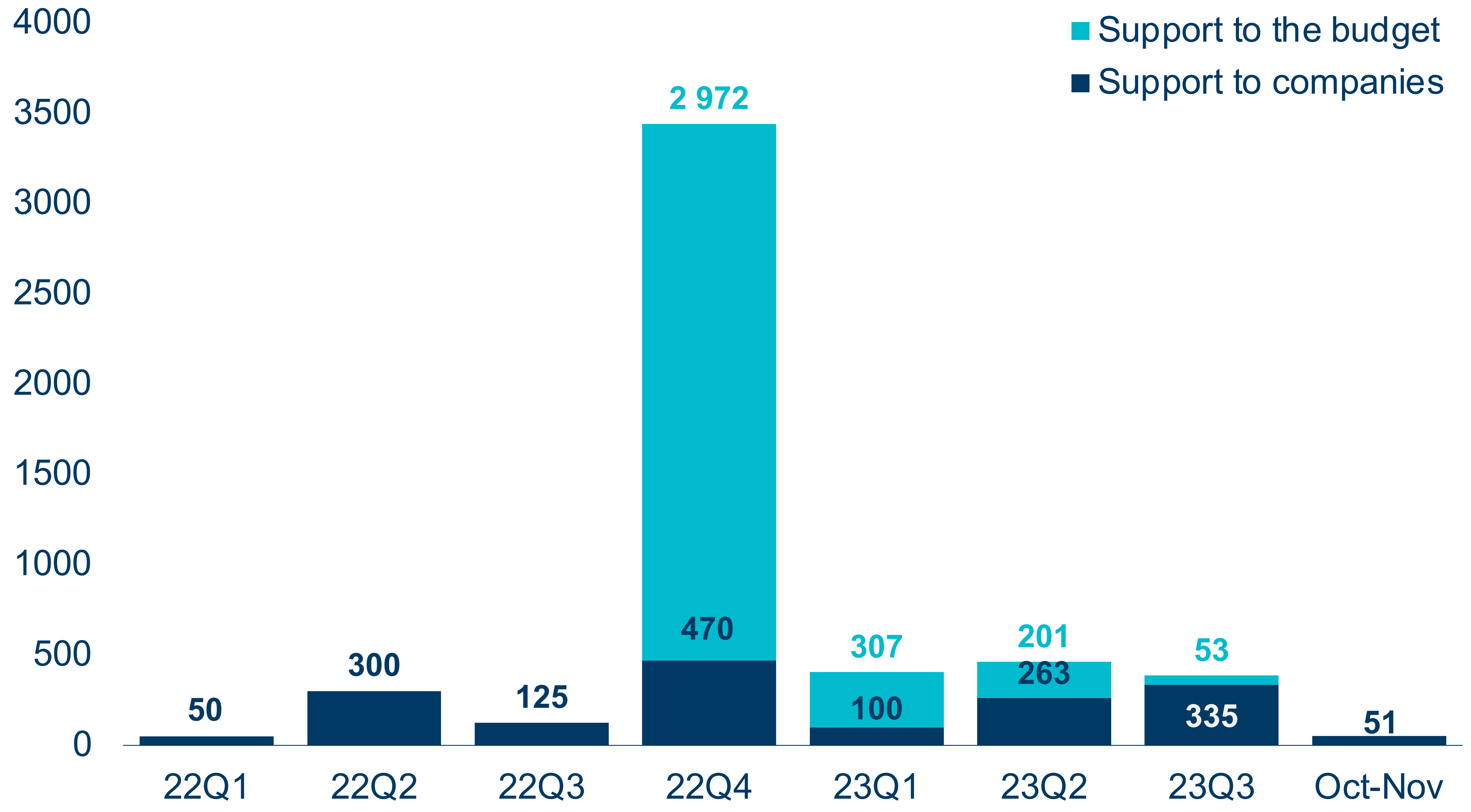
- Total assets of the National Welfare Fund stood at 13.4 trillion rubles ($151.1 billion, 9.0% of GDP) at the end of November.
- Liquid assets (e.g., foreign currency and gold) accounted for 50.2% of the total and non-liquid assets (e.g., stocks) for 49.8%.
- Withdrawals from the NWF support companies and the budget have dropped sharply after a record-high Q4 2022.

Assets of the NWF, in ruble billion and U.S. dollar billion



Source: Ministry of Finance, KSE Institute

Utilization of the NWF, in ruble billion



Source: Ministry of Finance, KSE Institute

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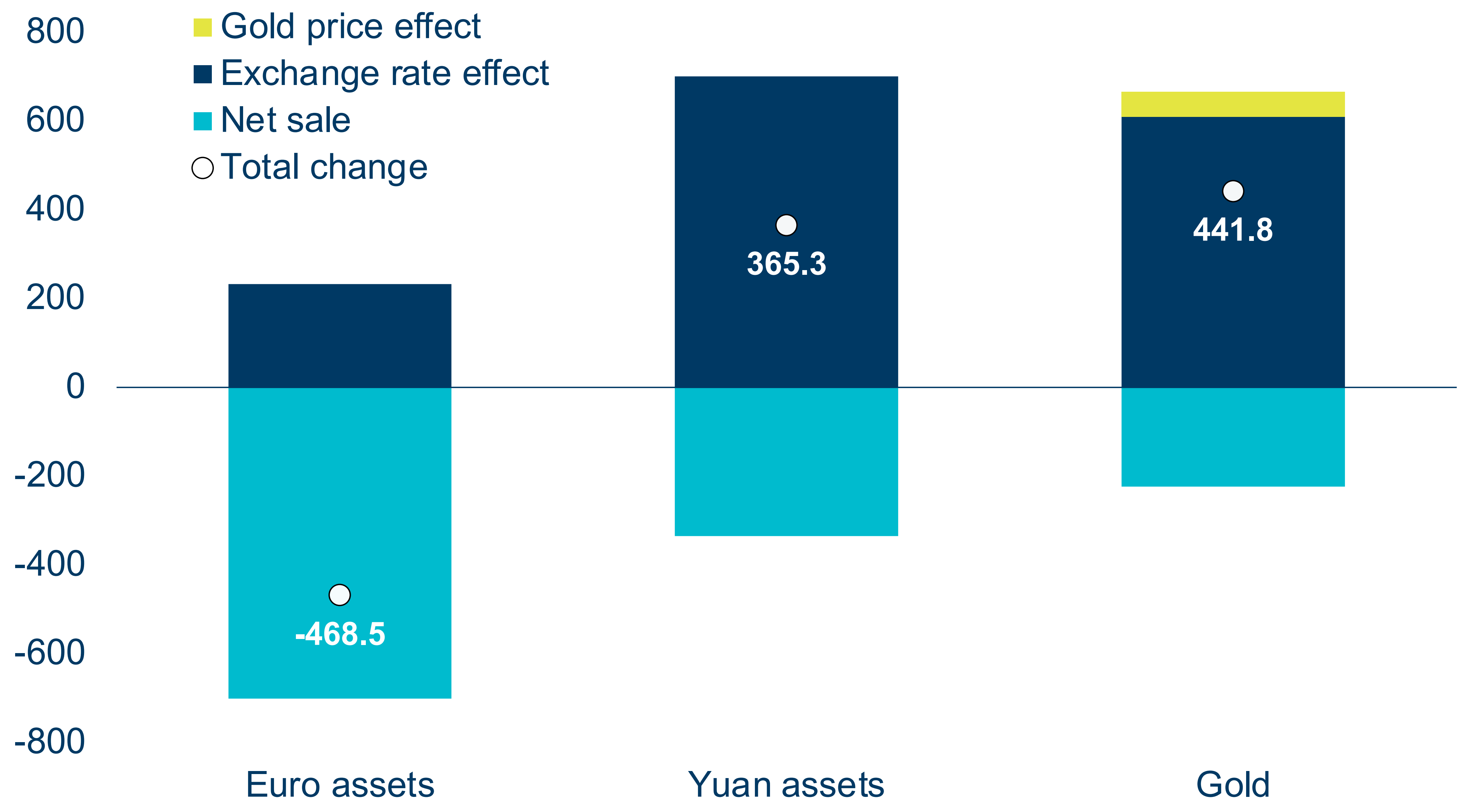
Russia will be able to rely on the NWF for financing for quite some time.

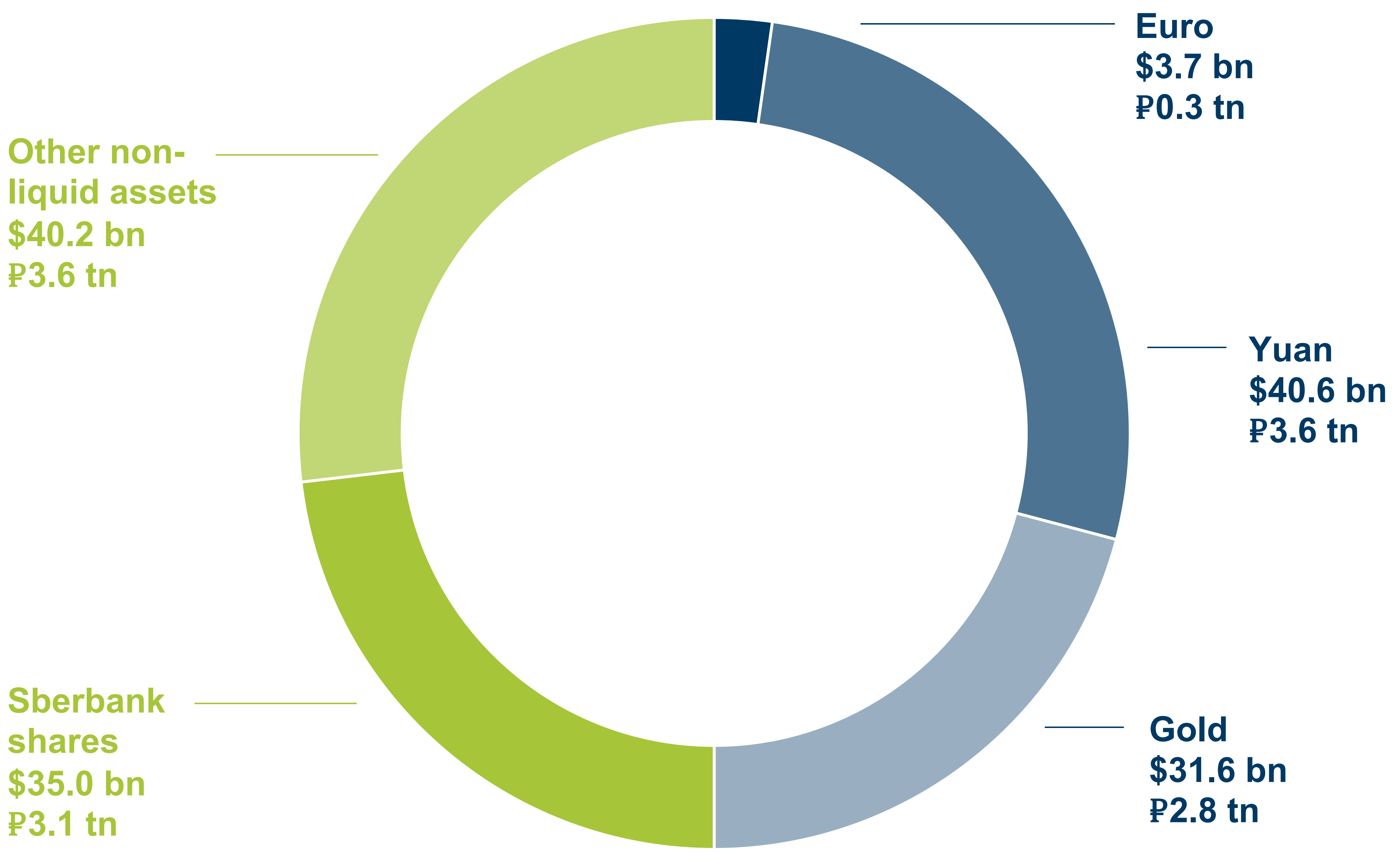
- Moderate net sales of euro/yuan assets and gold were offset by exchange rate, valuation effects.
- In the absence of a much wider deficit, withdrawals will likely remain moderate for the rest of the year.
- Therefore, Russia will be able to rely for longer than originally anticipated on the NWF for financing.

Change in assets (Nov. 2023 vs. Dec. 2022), in ruble billion*



Source: Ministry of Finance, KSE Institute *based on market exchange rates/prices

Composition of NWF assets as of November 1, 2023*

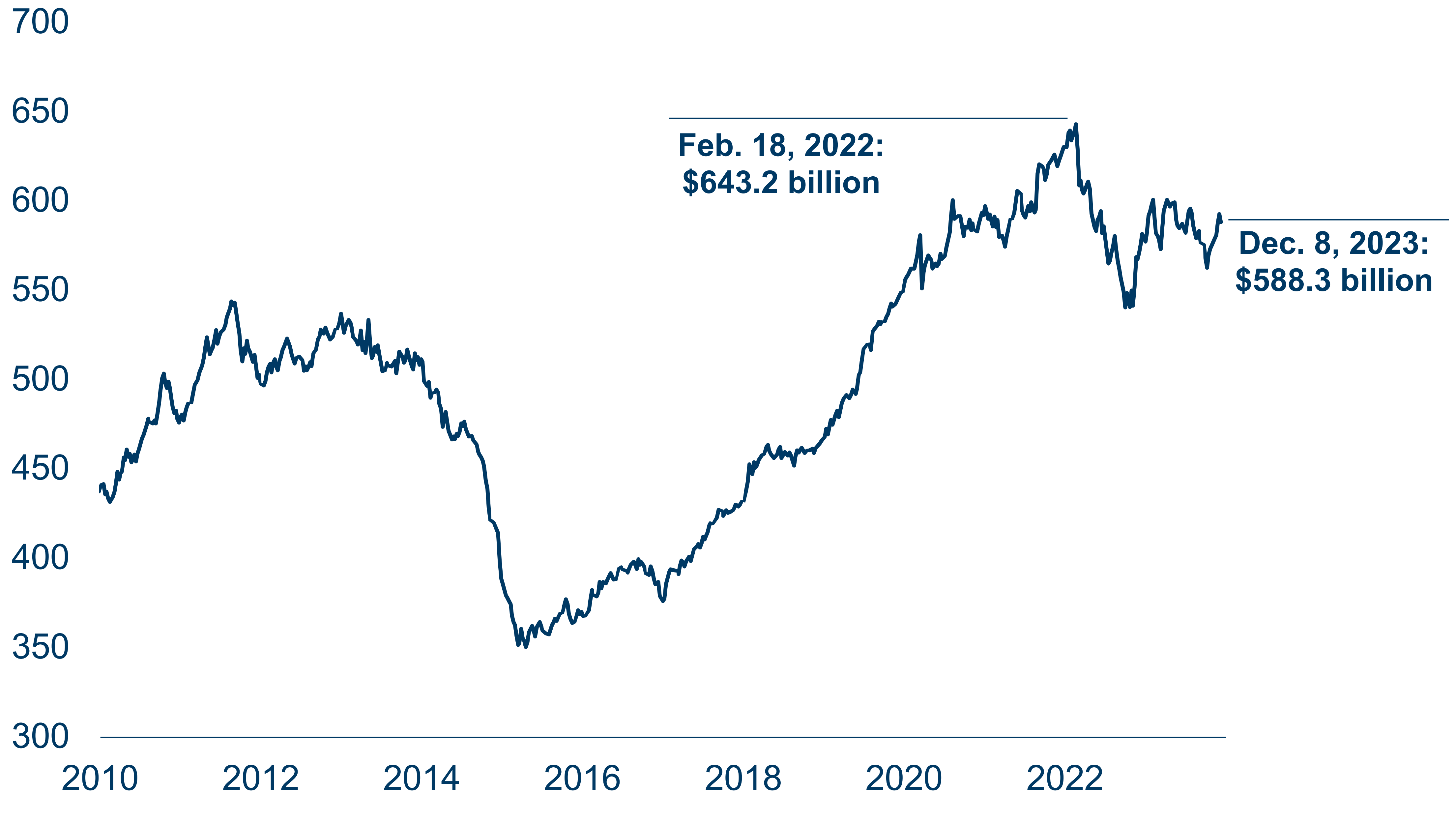


Source: Ministry of Finance, KSE Institute *based on market exchange rates/prices

A substantial share of international reserves have been immobilized.

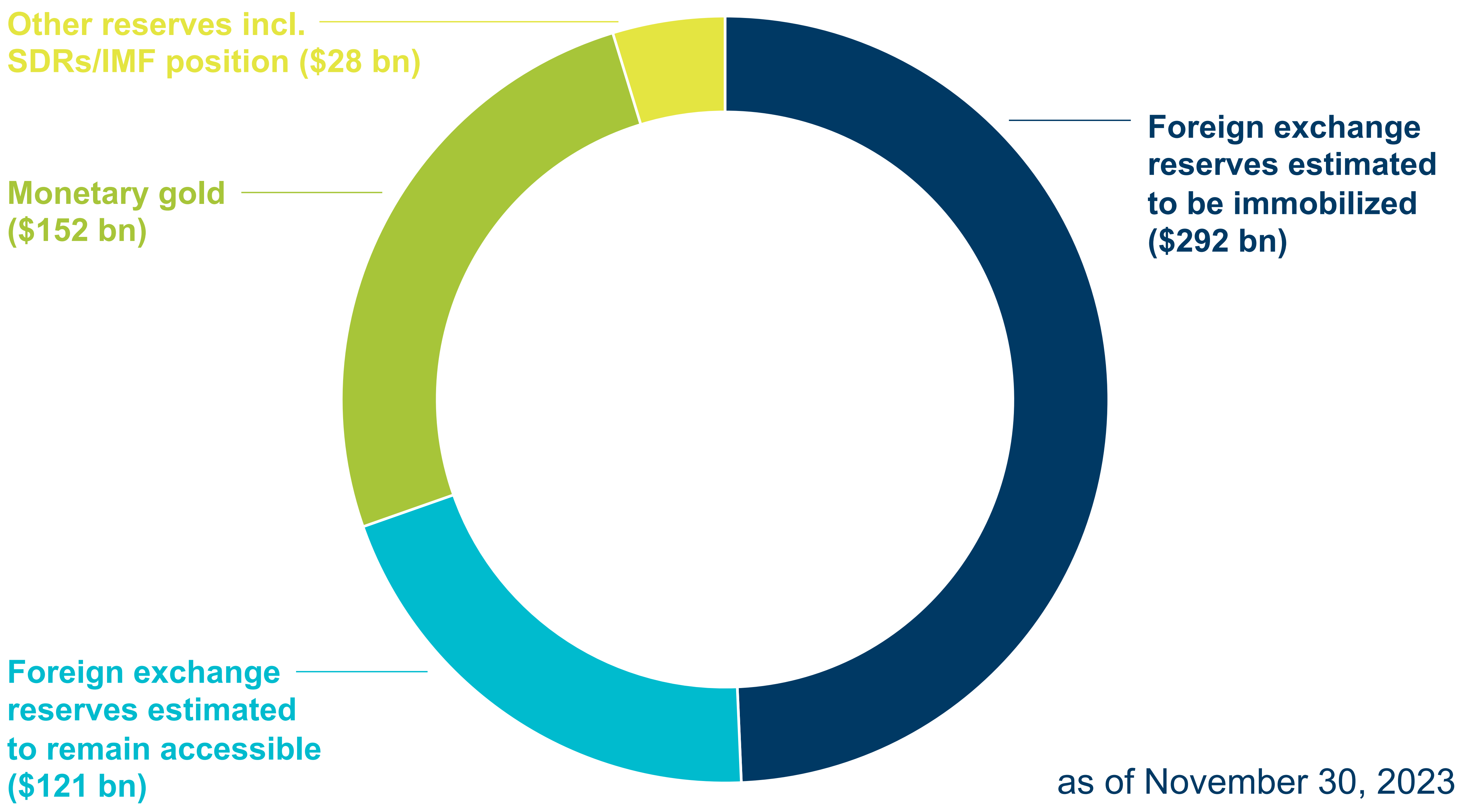
- Before the invasion, Russia held $634 billion in international reserves, part of what is described as *“Fortress Russia”.*
- We estimate that around $292 billion are currently immobilized due to international sanctions on CBR and NWF.
- This leaves Russia with access to $152 billion in monetary gold and roughly $121 billion in FX assets (largely yuan).

Total reserves, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

Estimated composition of reserves, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

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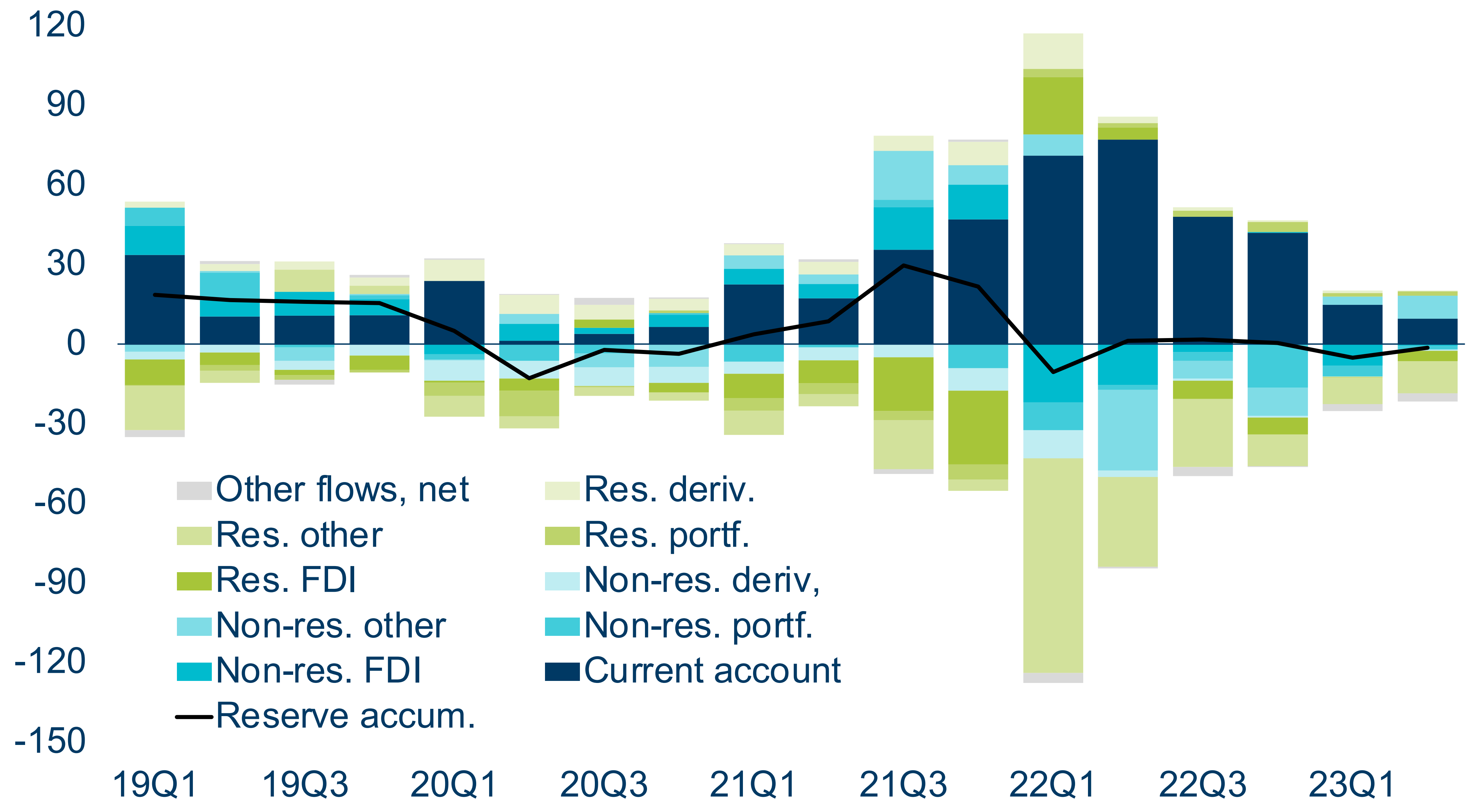
Significant accumulation of new foreign assets in 2022-23.

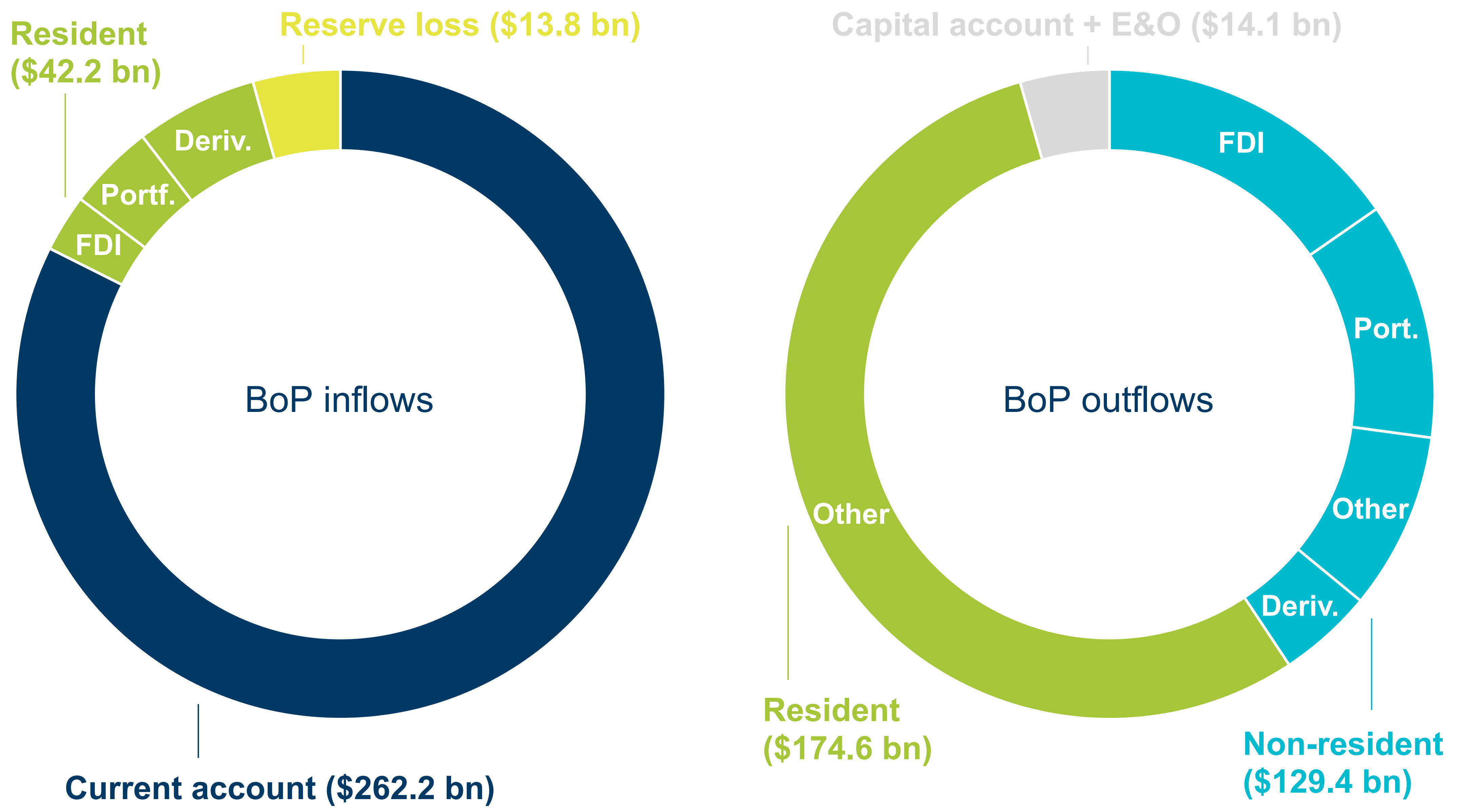
- It is time to focus attention on foreign assets that Russia has been able to accumulate due to favorable BoP dynamics.
- Non-resident capital outflows partially ate up the large current account surplus and resident inflows in 2022Q1-2023Q2.
- But Russian banks and corporates were able to acquire $175 billion in assets abroad, which need to be kept out of reach.

Balance of payments, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

2022Q1-2023Q2 balance of payments flows, in U.S. dollar billion



Source: Bank of Russia, KSE Institute

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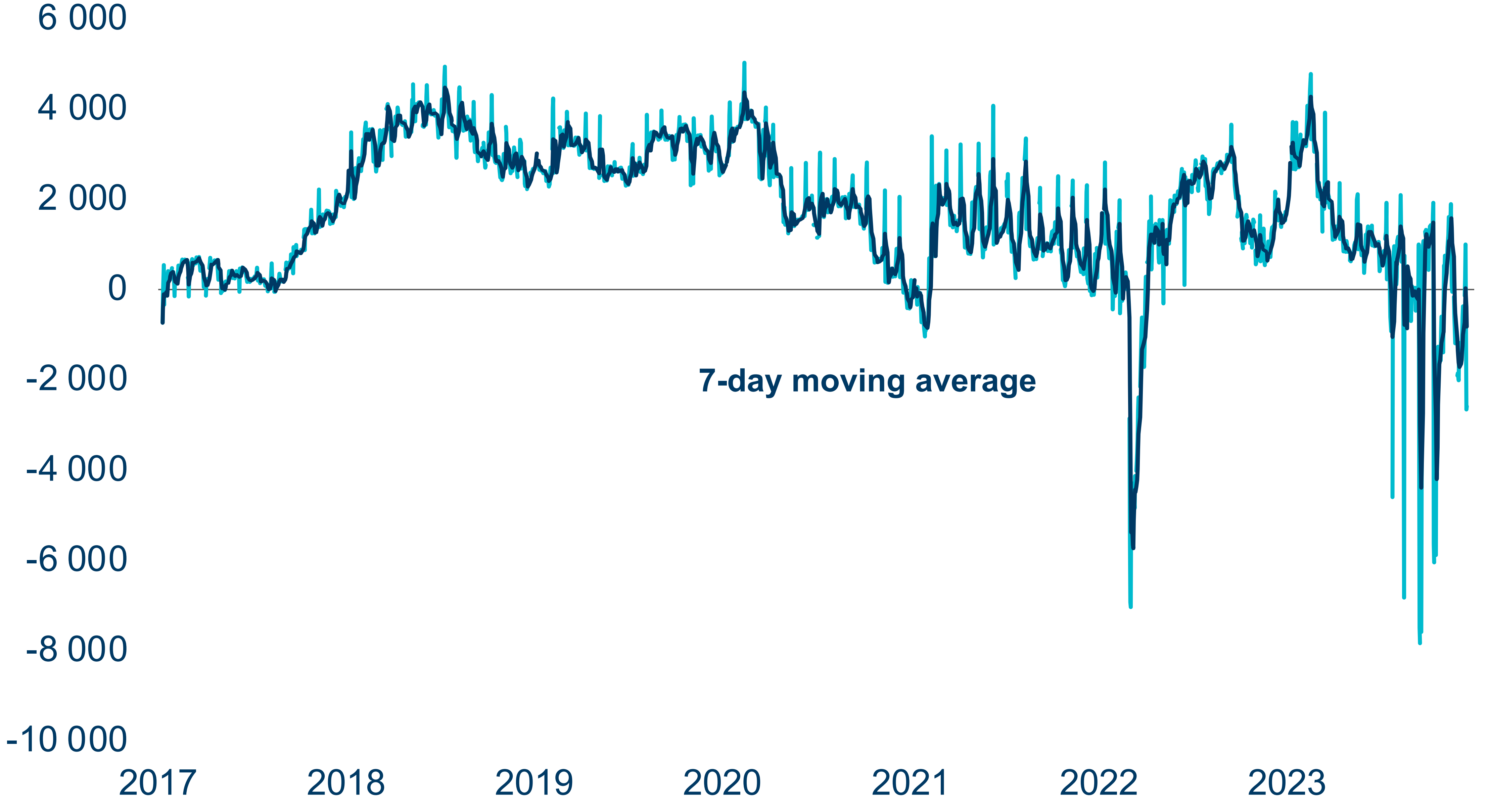
CBR rate hikes have impacted banking system liquidity in recent months.

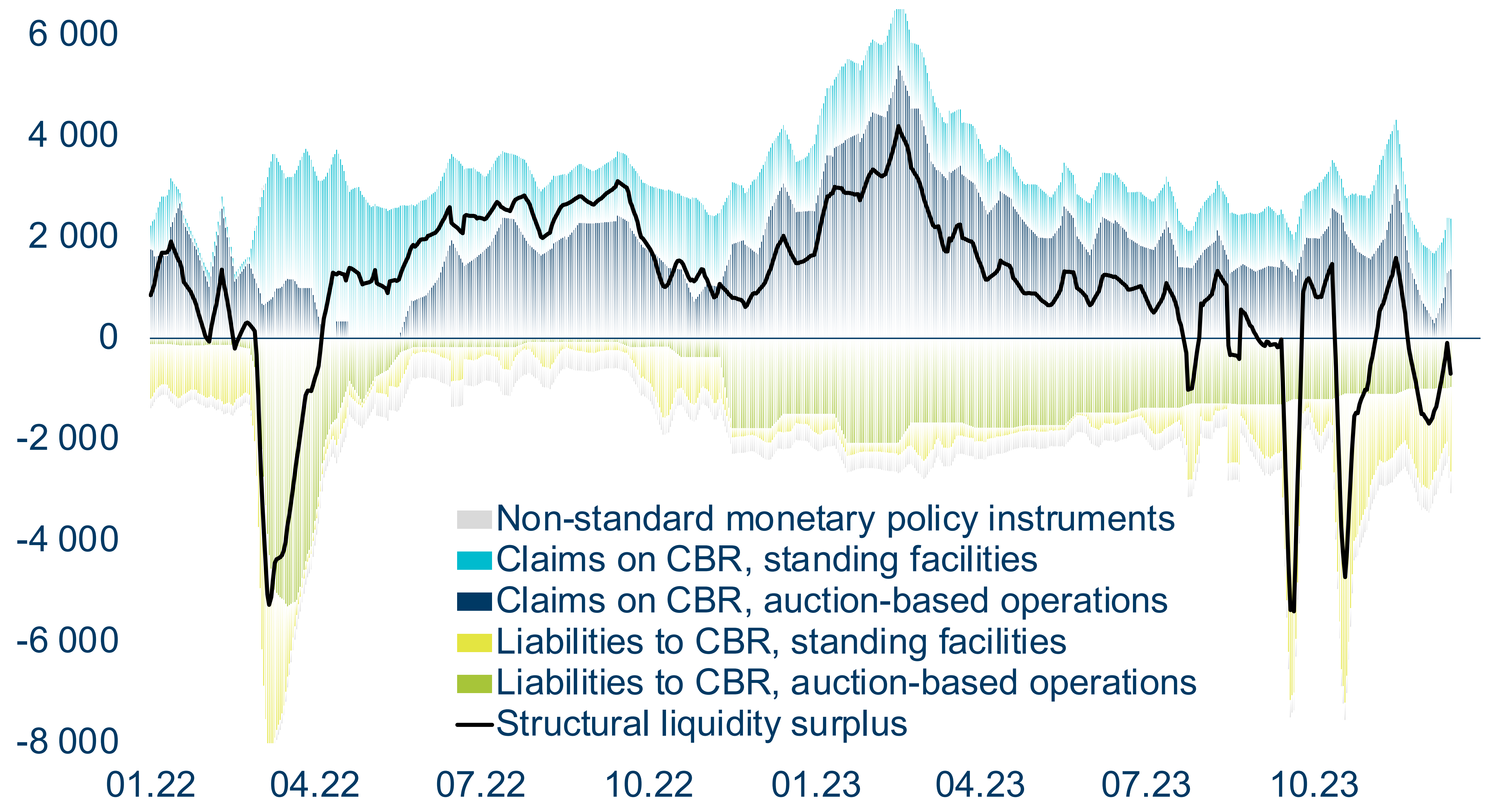
- Liquidity conditions recovered quickly after the initial shock from the full-scale war and imposition of sanctions.
- A closer look at the composition of the structural liquidity surplus points to some stress in the interbank market.
- The data clearly shows the effects of the CBR's monetary tightening in July-December 2023 (cumulative +850 bps).

Banking system structural liquidity surplus, in ruble billion



Source: Bank of Russia, KSE Institute

Composition of structural liquidity surplus, in ruble billion*



Source: Bank of Russia, KSE Institute *7-day moving average

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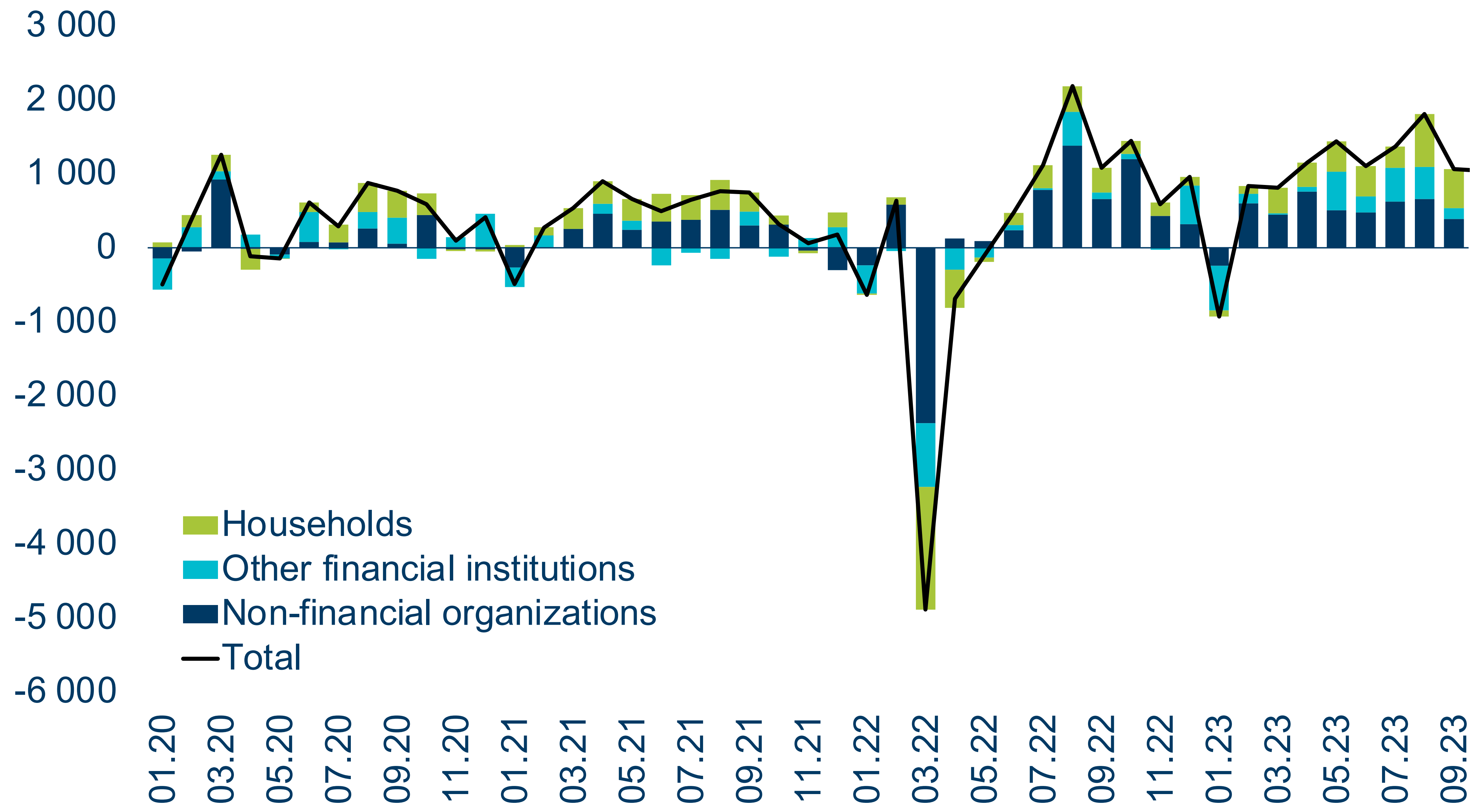
Private sector credit growth robust for the moment.

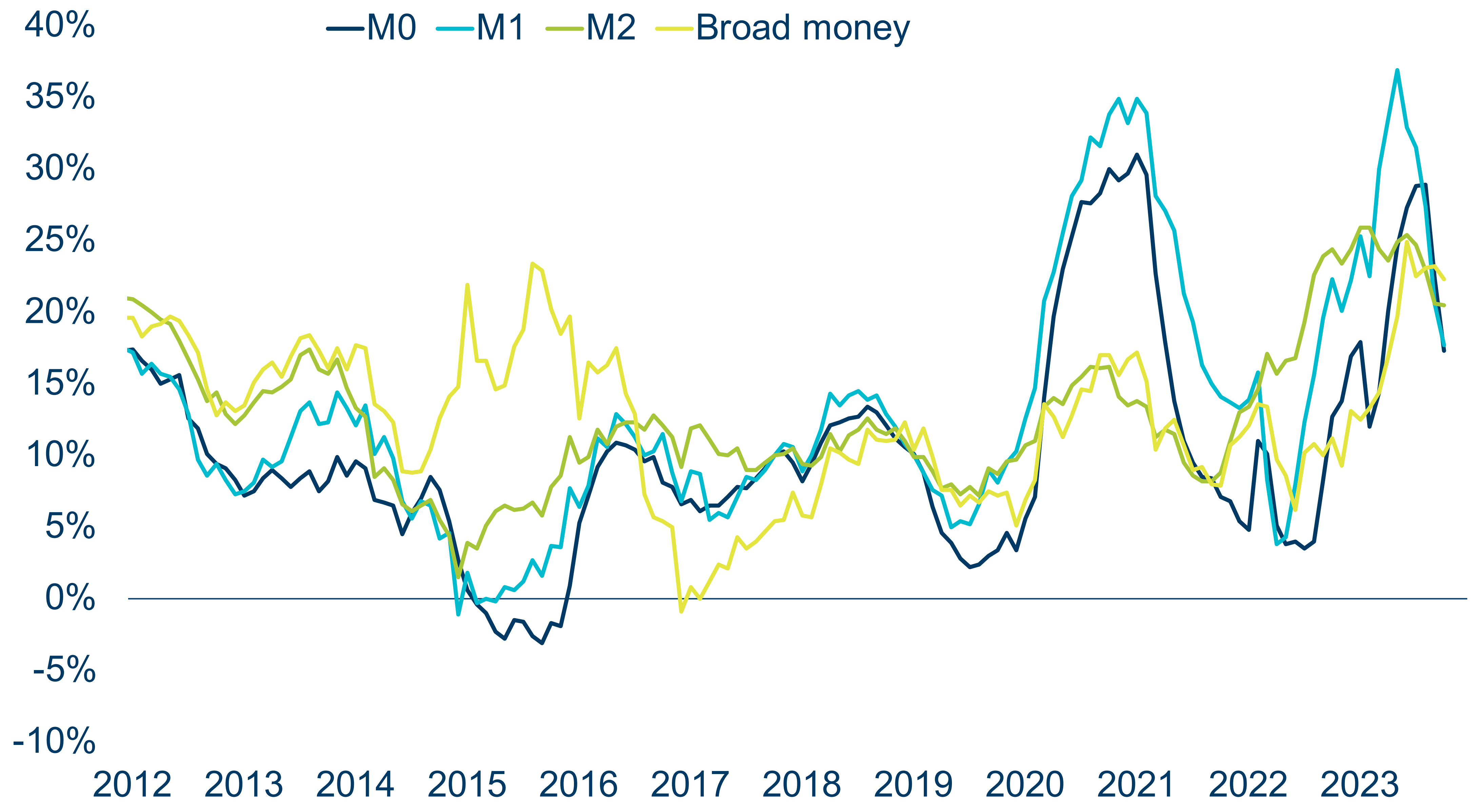
- Due to the provision of sufficient liquidity by the CBR, banks have been able to provide the private sector with credit.
- The CBR was able to simultaneously address monetary and financial stability in 2022 due to the supportive environment.
- With FX inflows down and the ruble under pressure, conflicts between the two objectives will increasingly emerge again.

New ruble-denominated credit, in 2020 ruble billion*



Source: Bank of Russia, KSE Institute *deflated using CPI

Growth of monetary aggregates, in % year-over-year



Source: Bank of Russia, KSE Institute

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Economic activity: return to growth in 2023-24, but prospects in the medium-/long-term are challenging

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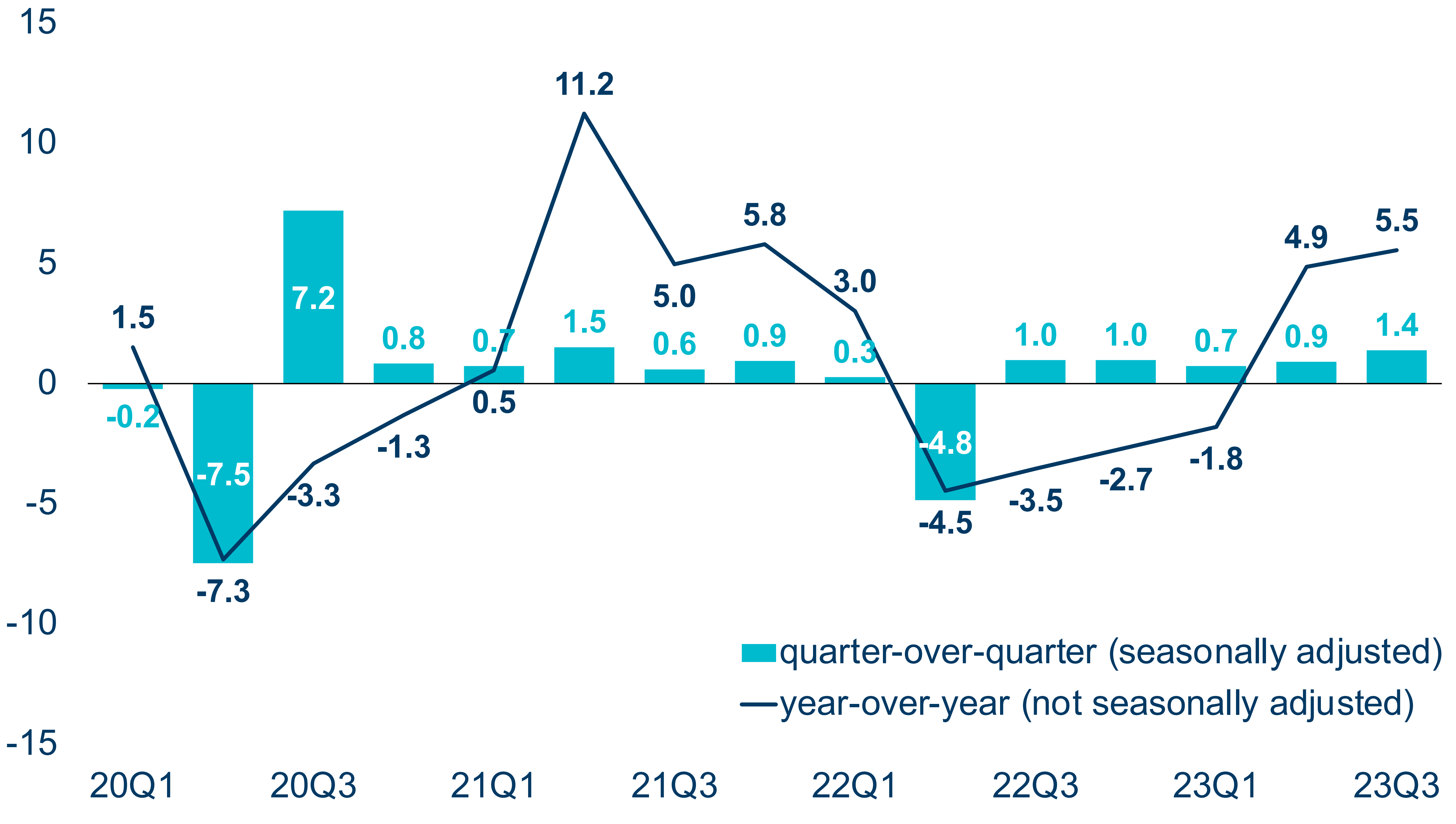
Russia's economy is on track for robust growth in 2023-24.

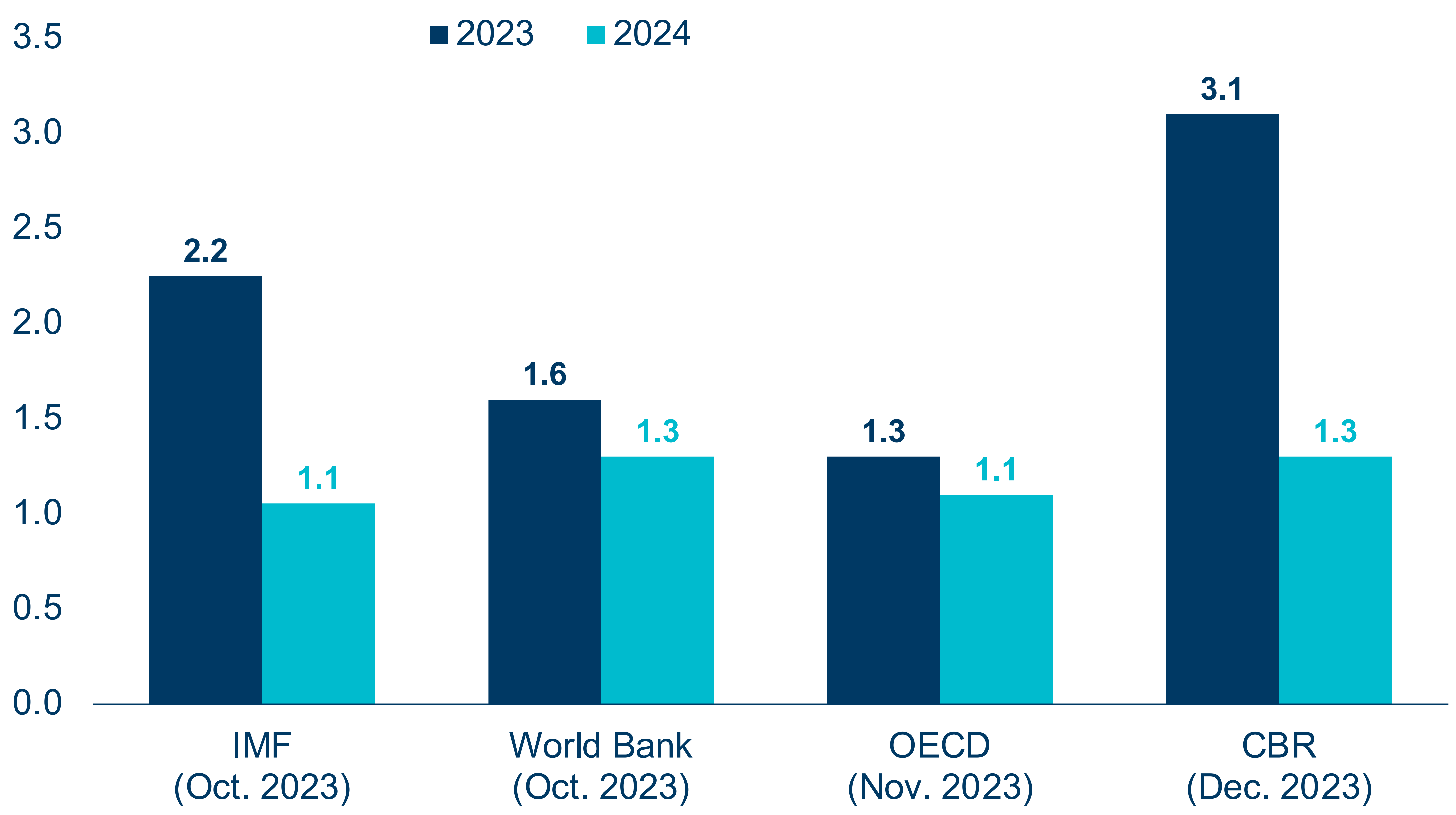
- Rosstat reports a pickup in growth—partially due to base effects—with 4.9% and 5.5% y/y in Q2 and Q3, respectively.
- For the full year, the economy is expected to growth at a robust rate, with most forecasts revised upward in recent months.
- Key factors for the recovery: strong fiscal stimulus from high defense spending and robust private sector credit growth.

Quarterly real GDP dynamics, in %



Source: Rosstat, KSE Institute

2023-24 forecasts for Russian real GDP, in % year-over-year



Source: Bank of Russia, Bloomberg, IMF, OECD, World Bank

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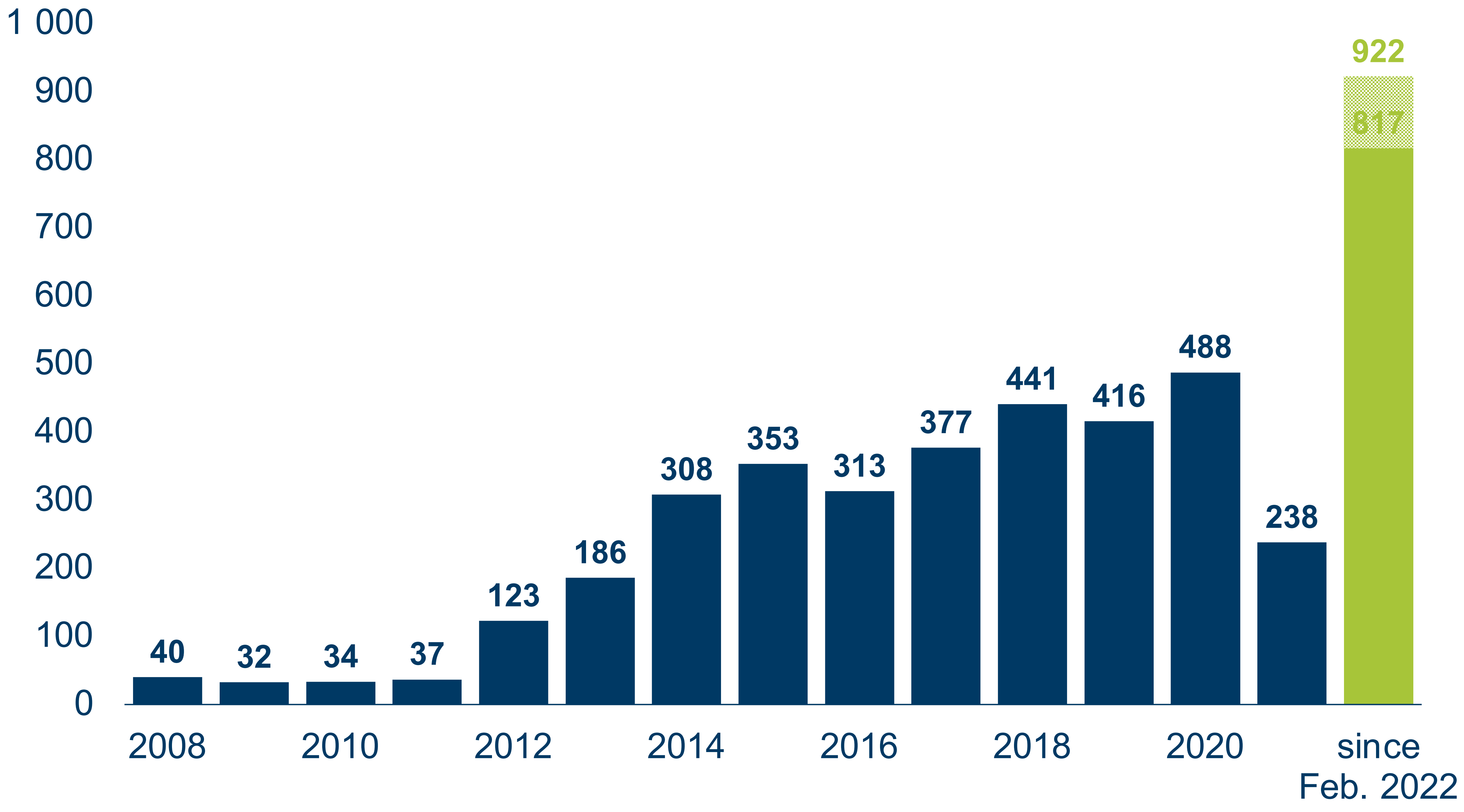
Medium- to long-term prospects of the economy are dire.

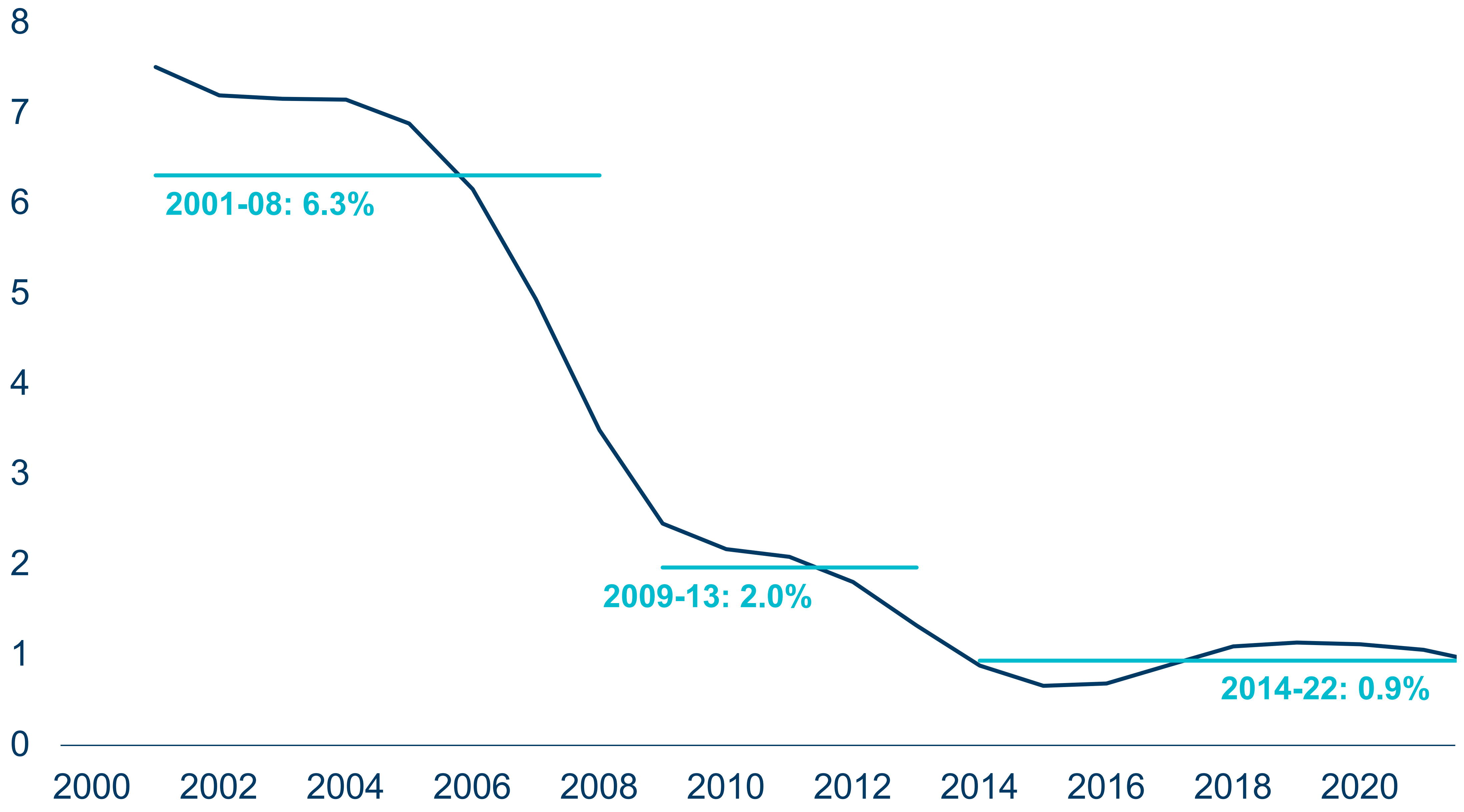
- Emigration is estimated to have picked up considerably since February 2022—to 817,000-922,000.
- Thus, an economy with previously abysmal potential growth is facing a significant shortage of (skilled) labor.
- Furthermore, once fiscal stimulus is withdrawn, the economy's fundamental weaknesses will surface.

Emigration from Russia, in thousand persons



Source: Re:Russia, Rosstat, KSE Institute

Potential GDP growth, in % year-over-year*



Source: Rosstat, KSE Institute *calculated using H-P filter

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Previous editions of KSE's Russia chartbook

- November 2023
- October 2023
- September 2023
- July 2023
- May 2023
- April 2023
- March 2023
- February 2023
- December 2022