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KSE Institute Russia Chartbook

Further Weakening of Russian Macroeconomic Stability Will Require Additional Measures

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Executive Summary

1. **New "normal" regarding foreign trade.** Russia's goods trade has settled into a new post-sanctions baseline with exports of around $100 billion and imports of around $75 billion per quarter. As a result, the trade surplus has shrunk dramatically—by 62% and 79%, respectively, in 2023 vs. 2022. This much more challenging external environment is also what is driving persistent depreciation pressure on the ruble, which, in turn, forced the central bank to hike interest rates sharply and re-introduce capital controls.
2. **Tanker designations an effective strategy.** Enforcement action by OFAC has shown that Russia's shadow fleet of tankers operating outside of the price cap regime is not beyond the coalition's reach. Out of 41 sanctioned vessels, only 5 are completing pre-sanctions voyages; the others are unloaded without scheduled voyages or unable to find buyers for the cargo they are currently carrying. Banks have also become much more reluctant to engage in the trade due to the risk of facing sanctions themselves.
3. **Rising expenditures drive up budget deficit.** The January-February federal budget deficit reached 1.5 trillion rubles—92% of the full-year plan—on the back of sharply higher expenditures. Revenues from oil and gas, however, recovered in February driven by changes to the energy tax regime and supported by rising global oil prices. Due to uncertainty surrounding future revenue collection, Russian authorities are considering increases to individual and corporate income taxes worth a total of 4 trillion rubles.
4. **Drained macro buffers will constrain policy space.** Russia has had to rely primarily on the NWF for financing of its budget. In fact, almost half of the fund's liquid assets, including all hard currency, have been used up since the February 2022. Going forward, the Russian banking system will likely have to carry more of the burden. Sanctions have also significantly constrained access to reserves.
5. **GDP numbers conceal vulnerabilities.** The Russian economy is benefitting from a large war-related fiscal stimulus, with growth reaching 3.6% in 2023 according to Rosstat. The stimulus will become even stronger this year as military spending could add around 2.5pp to GDP growth in 2024. Thus, it is not surprising that economic activity has essentially fully rebounded from the initial shock due to the war and sanctions. However, the underlying fundamentals of the economy are weak, and problems will eventually resurface.
6. **More action is needed to constrain Russia.** Coalition efforts have significantly weakened Russia and limited policy space, but further eroding macroeconomic stability and constraining its capacity to wage war depends on additional measures taken.

Energy: further action is critical to constrain Russia’s energy revenues.

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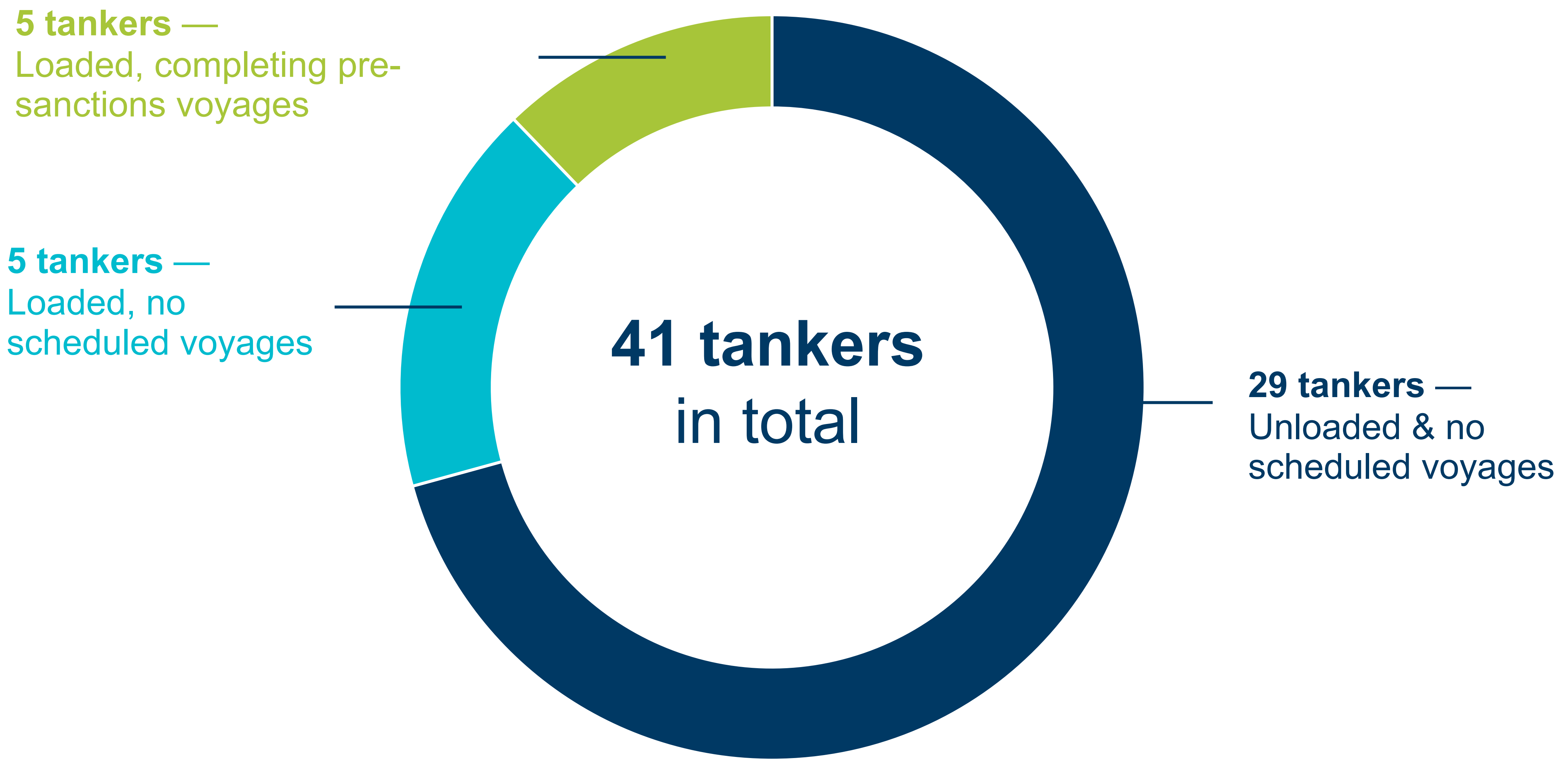
Designation of vessels effectively removes them from the market.

- The U.S. Treasury Department (OFAC) has listed 41 vessels as assets of sanctioned entities in recent months.
- Only 5 tankers are completing pre-sanctions voyages; most of the others are unloaded without scheduled voyages.
- This enforcement strategy can and should be gradually scaled up to ultimately impact Russia’s entire shadow fleet.

OFAC-designated vessels remain out of the market



Source: Kpler, KSE Institute

Effects of vessel designations: the case of the NS Century

Source: Kpler, KSE Institute

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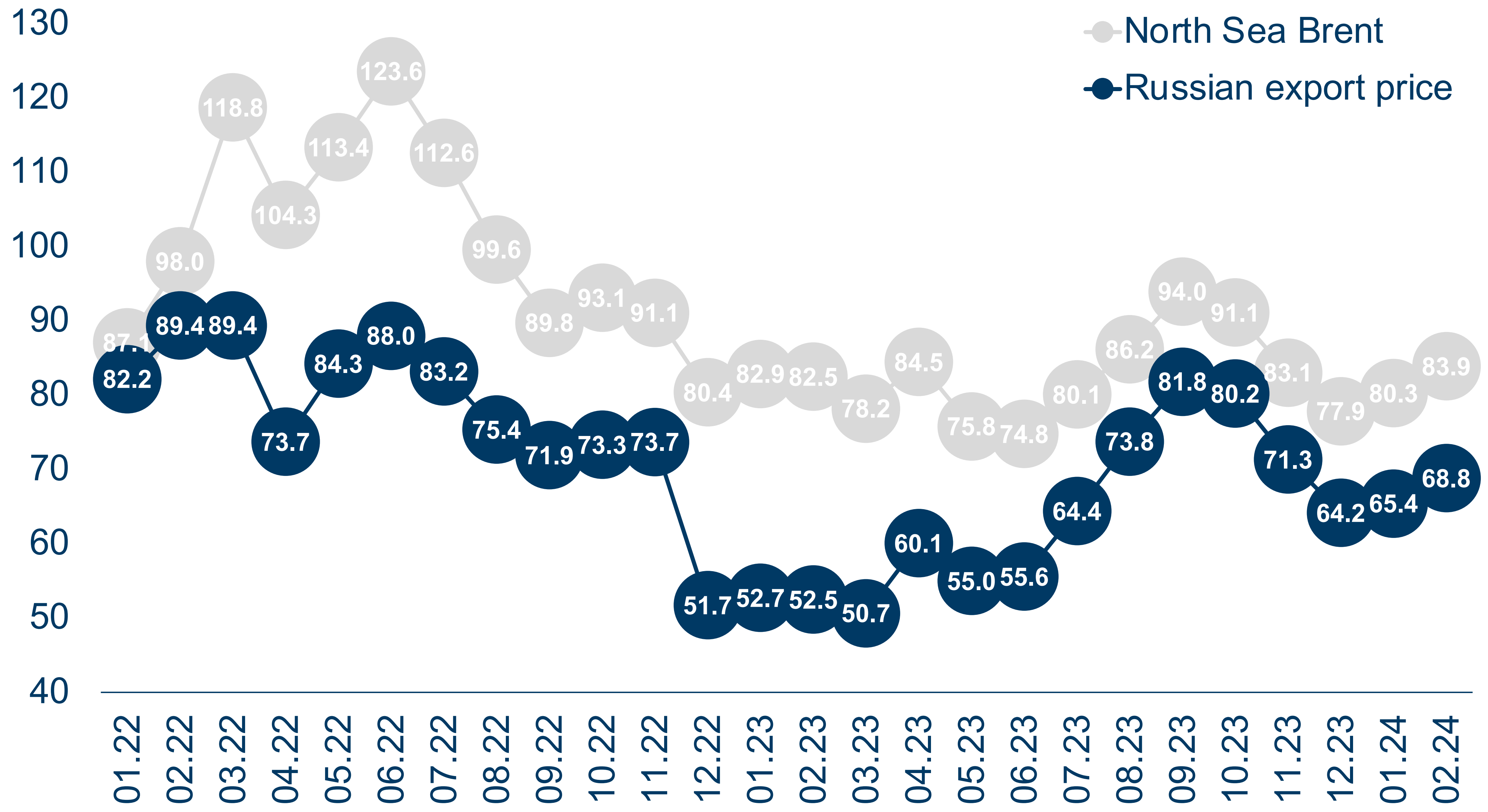
Discounts on Russian oil plateau, global prices rise.

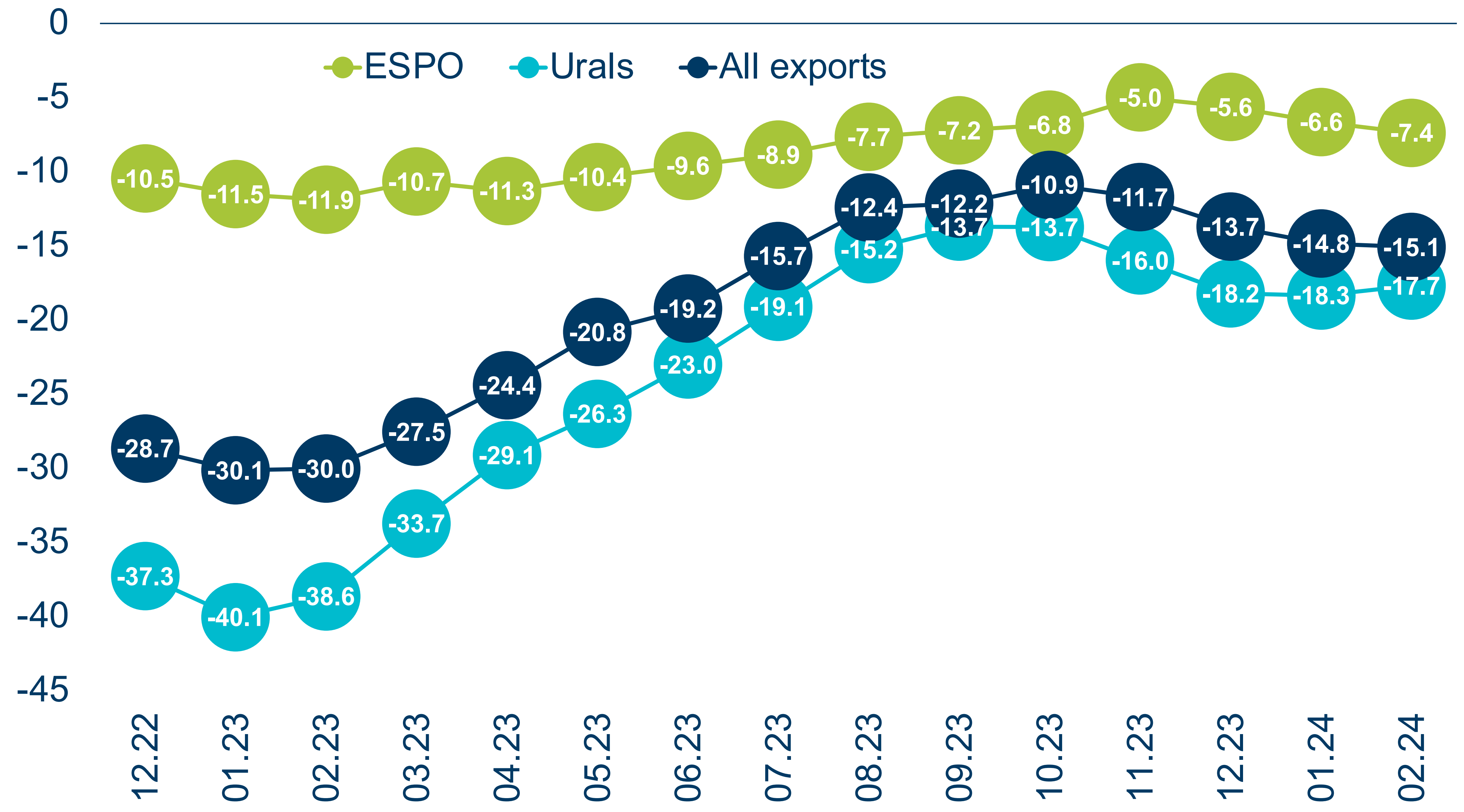
- Energy sanctions, in particular the EU embargo, weighed on Russian export earnings via wider price discounts.
- Recent G7/EU enforcement efforts are having an impact, with the Urals discount widening again to ~$18/barrel.
- However, with discounts remaining broadly stable in February, higher global prices improved Russia's position.

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

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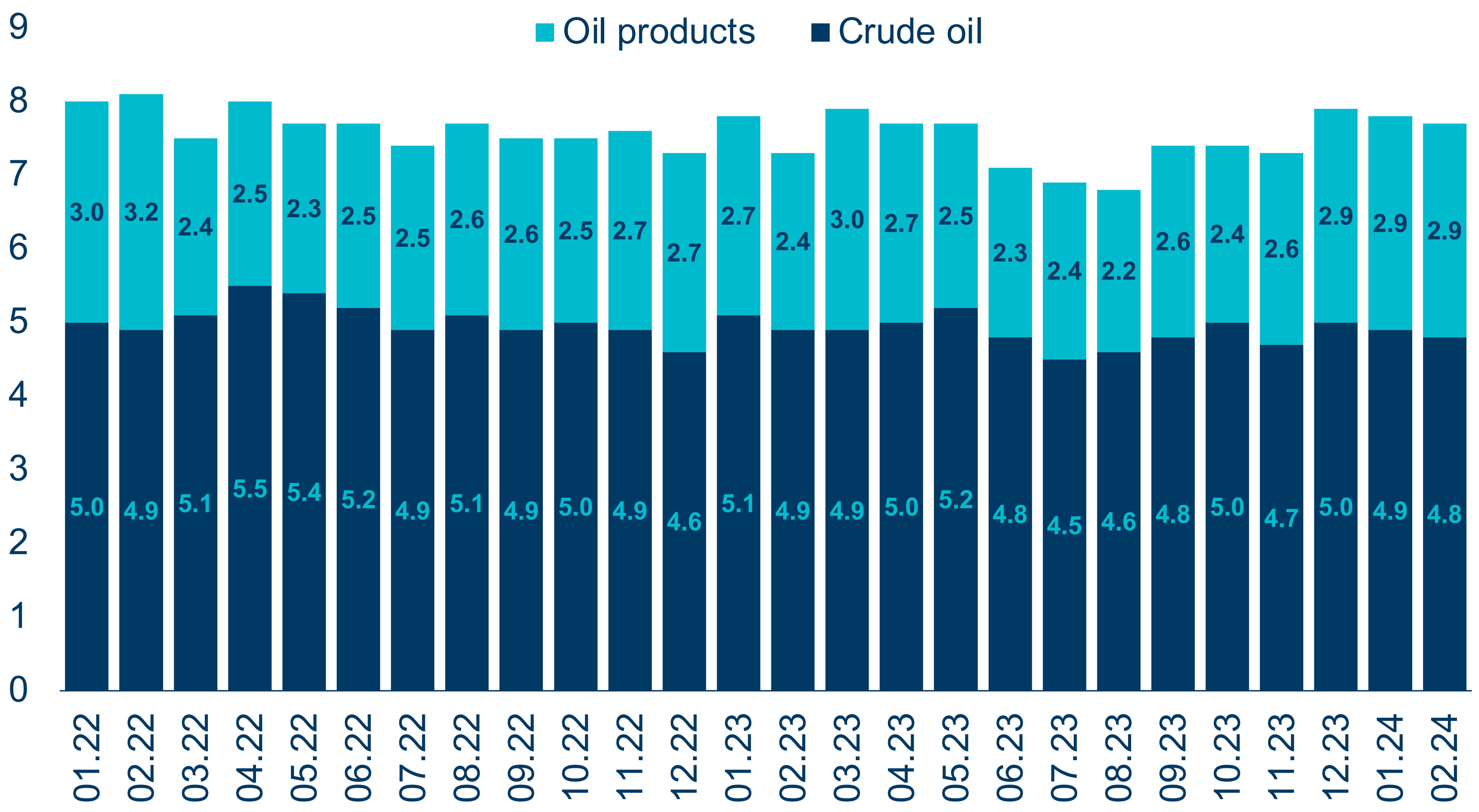
Russian oil export volumes remain stable.

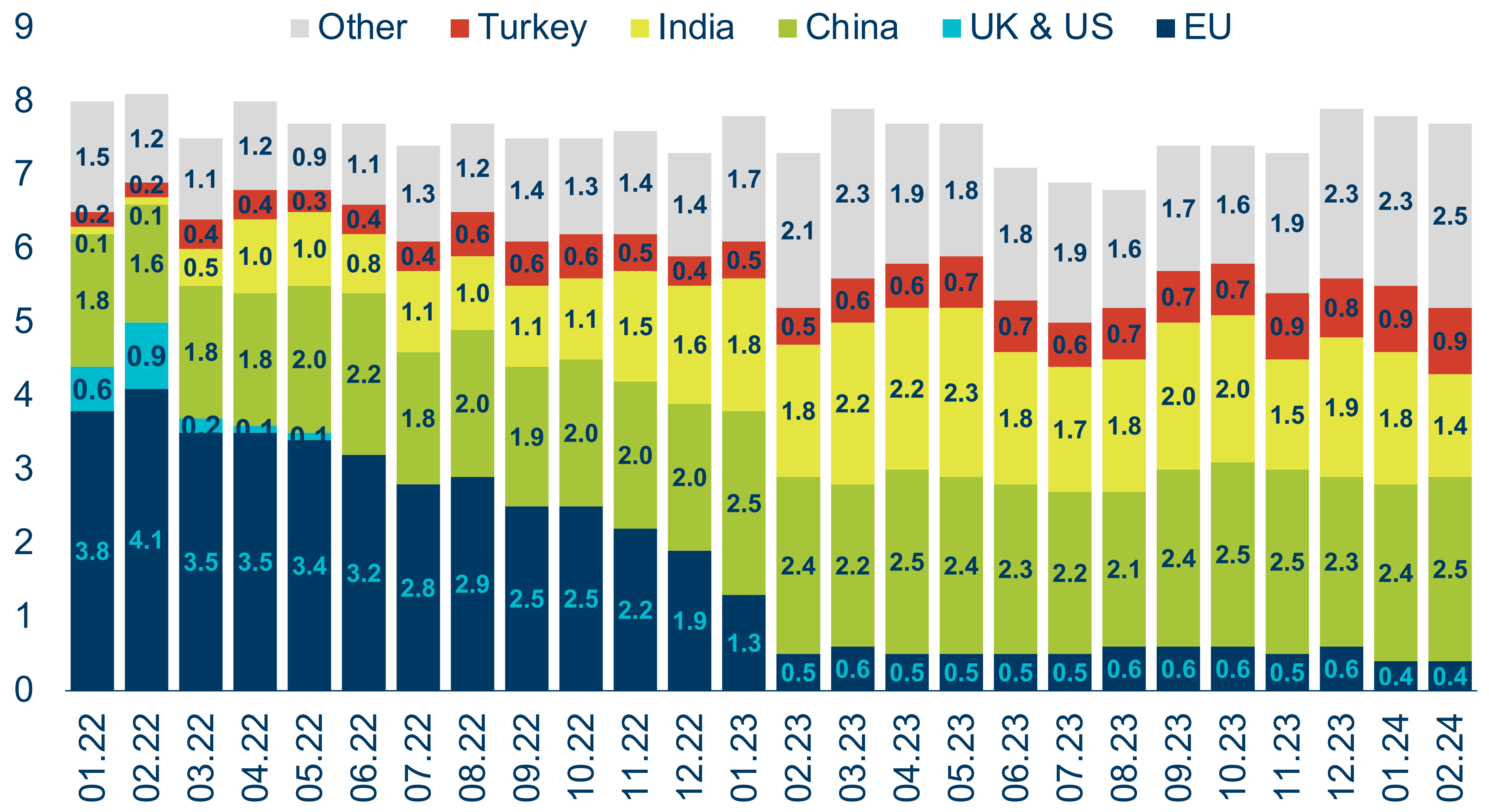
- Russian oil exports did not change significantly in January: crude oil declined by 3% and products remained stable.
- Shipments to India fell to 1.4 mbd, their lowest level since October 2022, as U.S. sanctions on shadow tankers bit.
- More broadly, the price cap regime has succeeded at keeping Russian oil on the market and prevent price shocks.

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

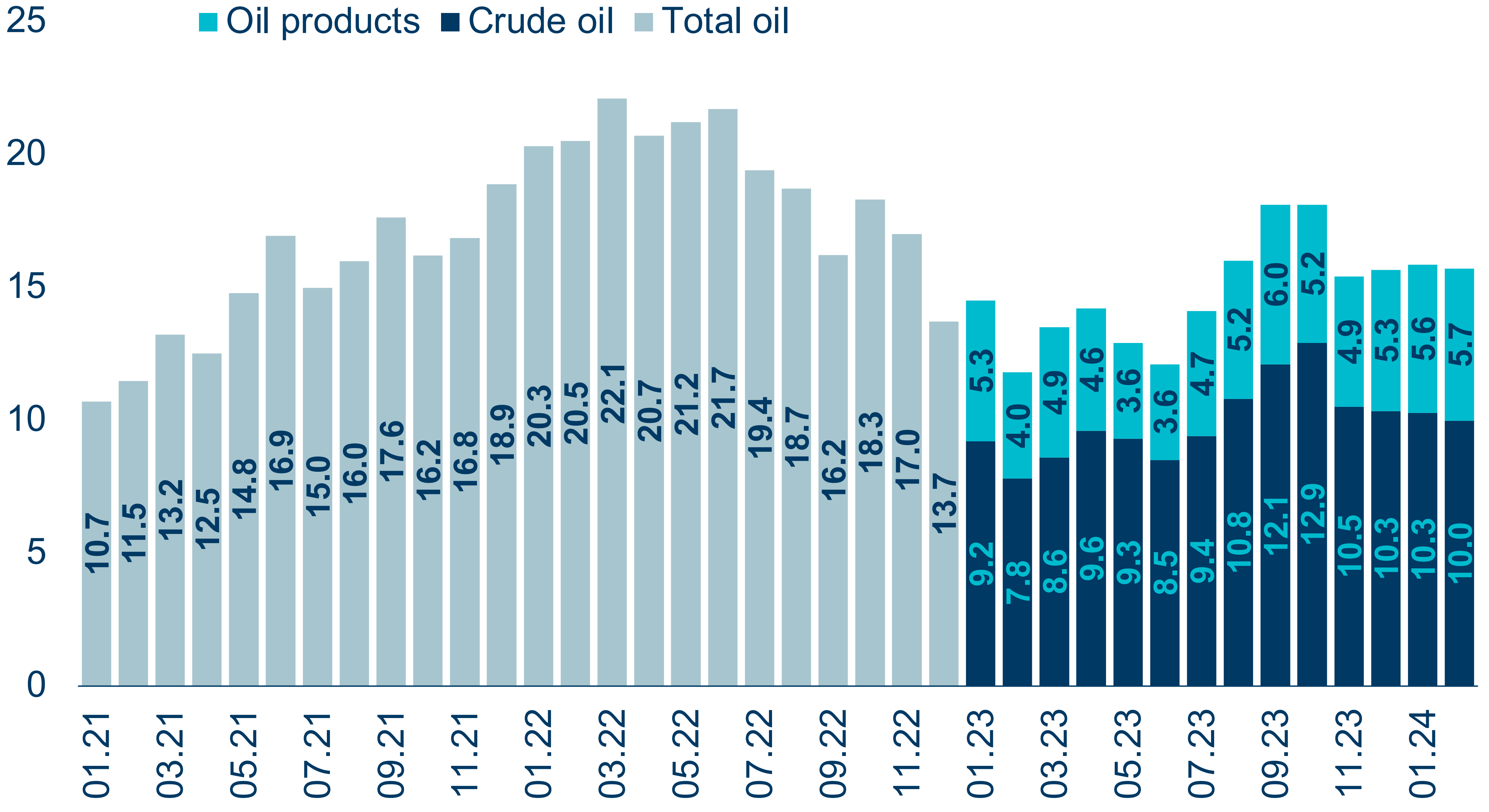


Source: International Energy Agency, KSE Institute

Higher prices support exports, budget benefits from tax changes.

- After reaching close to $18 billion in the fall, Russian oil exports have hovered around $15-16 billion in recent months.
- Somewhat smaller volumes offset higher prices in February, but Russia could see exports rebound without further action.
- The $3.40/barrel rise in the average export price delivered ~$470 million in additional earnings from crude oil last month.

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

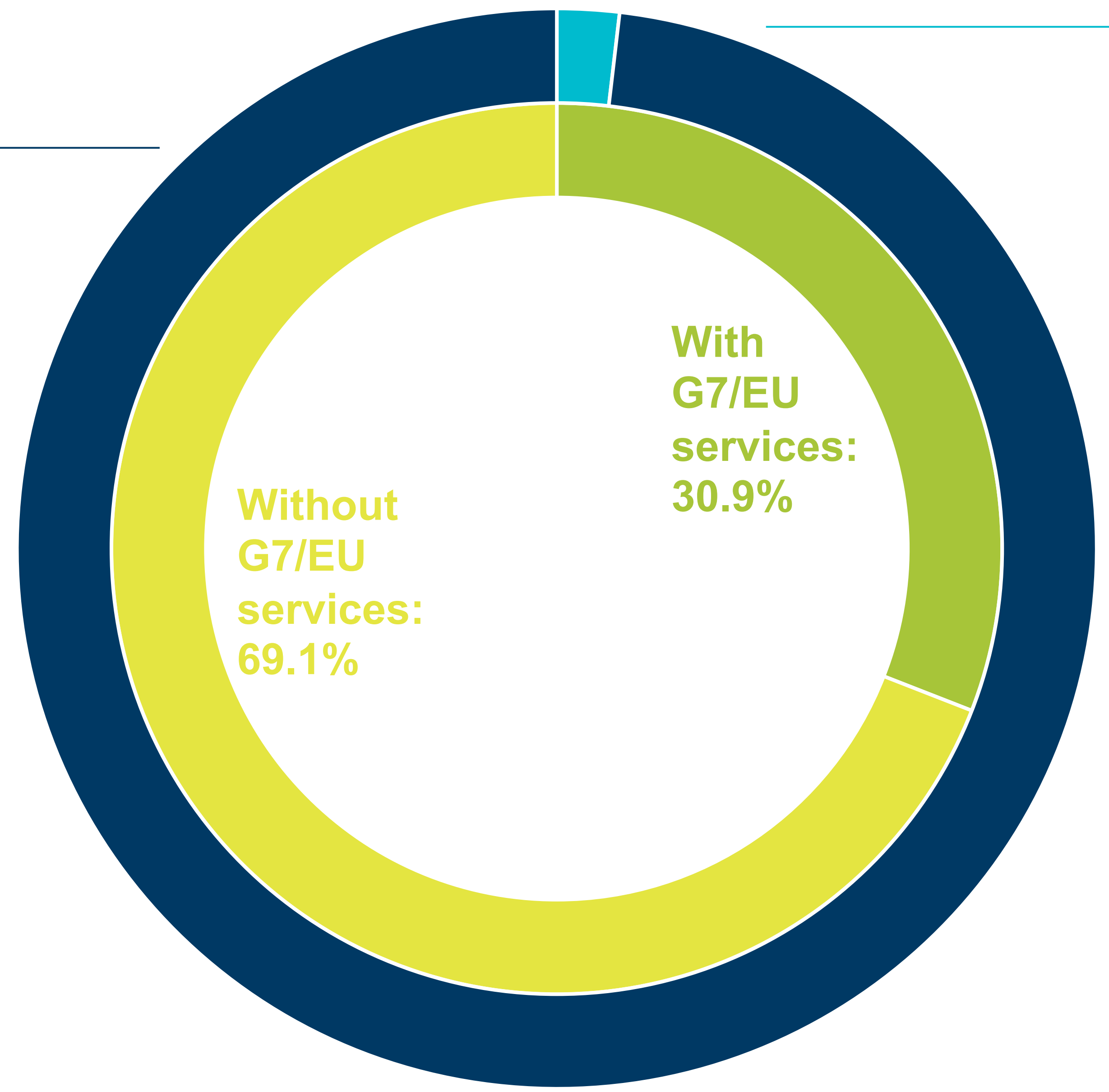
Federal budget oil revenues, in ruble billion*

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

Price cap challenges: violations and the shadow fleet.

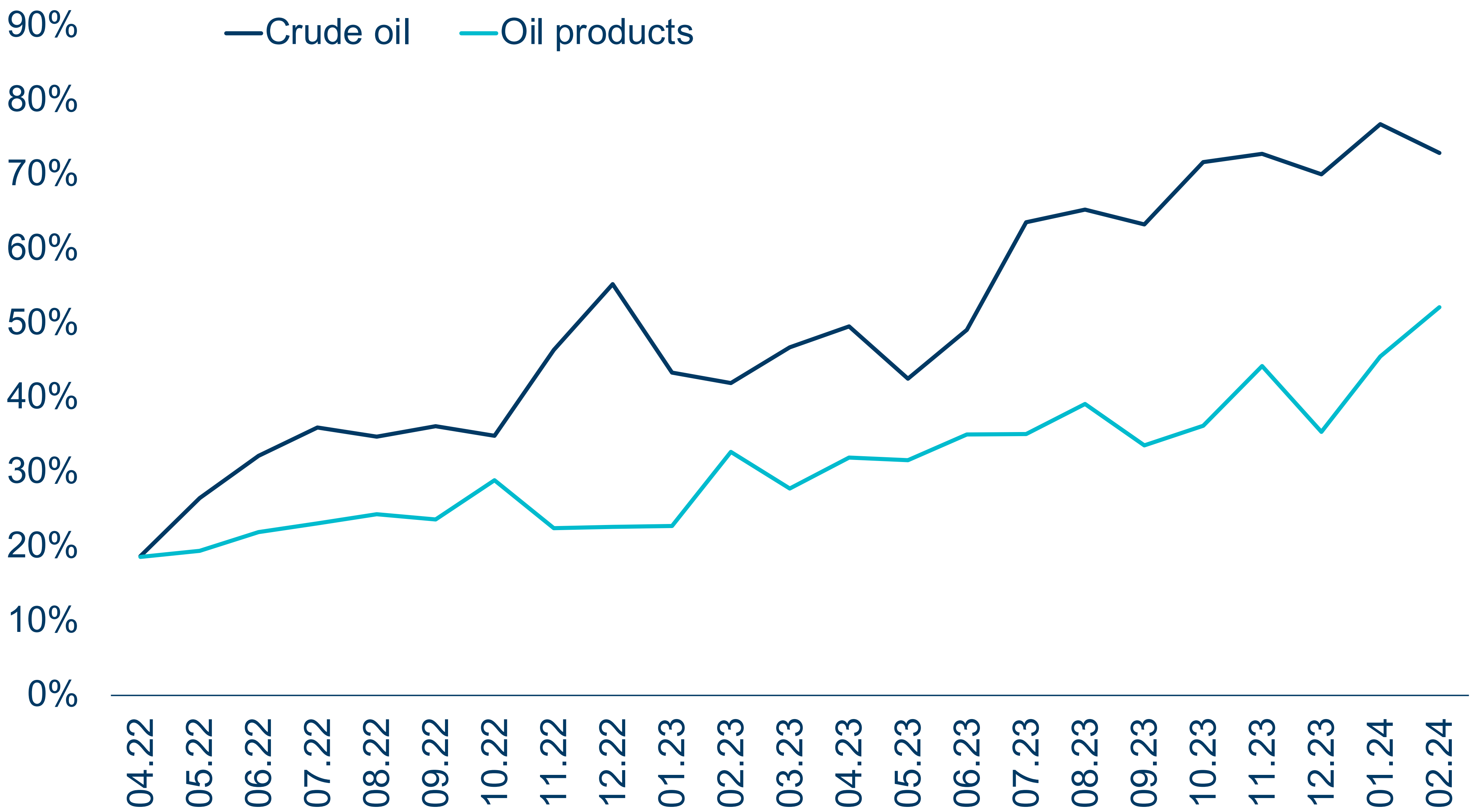
- The price cap continues to face two key challenges: compliance remains low, and the shadow fleet threatens its leverage.
- In Q4 2023, only ~2% of seaborne crude oil exports took place <$60/barrel, while G7/EU services played a role in ~30%.
- The volume share of the shadow fleet has risen to 73% in February 2024 for crude oil and reached 52% for oil products.

Composition of Russian seaborne crude oil exports in Q4 2023, in %



Source: Kpler, P&I Clubs, KSE Institute

Volume share of the Russian shadow fleet, in %



Source: Kpler, P&I Clubs, KSE Institute
Read KSE Institute's January 2024 *Russian Oil Tracker*.

Energy sanctions: four key steps to constrain Russia in 2024 and beyond.

Strengthening price cap enforcement and lowering the caps:

1. **Stop the Russian shadow fleet**, which circumvents the price cap and threatens the environment. By expanding the number of shadow tankers under sanctions and enforcing existing mandatory oil spill insurance requirements for all tankers passaging through coalition waters, we can force Russia to rely much more heavily on the mainstream fleet once again, which falls under price cap restrictions. Further, **step up investigations and penalties** to alter trade participants' risk calculations. By requiring greater transparency around price cap compliance, conducting comprehensive investigations into suspect transactions, and increasing penalties for violations, service providers and importers will demand higher fees (such as freight rates) and deeper price discounts.
2. **Ratchet down the price cap** once its efficacy is ensured and enforcement challenges addressed to deprive Russia of critical foreign currency inflows. We propose initially to reduce the crude oil price cap and the discount product price cap by $10/barrel each, and to reduce the premium product price cap of $100/barrel more substantially, which has generally been above the market price.

Further steps to reduce oil and gas earnings in the medium run:

1. **Complete the EU/G7 ban on Russian hydrocarbons** by eliminating all purchases of LNG and banning Russian gas flows to Europe. Such a measure would demonstrate the coalition's commitment to a permanent decoupling from Russian energy and deprive the aggressor of important future export earnings. This ban should be phased in over the next one to two years, as other gas supply comes onto the market, to avoid any sharp market tightening and rising prices.
2. **Target oil and gas-related services** that Russia relies on for production and exports. Russia's hydrocarbon sector has had restricted access to western technology since 2014, resulting in a negative impact on new developments. Many foreign companies also exited after February 2022. However, a significant number continue to operate in Russia. Cutting off such services completely could restrict future LNG production, while pushing up costs for oil production by eroding technology-driven efficiencies.

Read the latest working paper by the Yermak-McFaul International Working Group on Russian Sanctions here.

Trade: exports weakness extends into 2024; much smaller trade and current account surpluses undermine macroeconomic stability.

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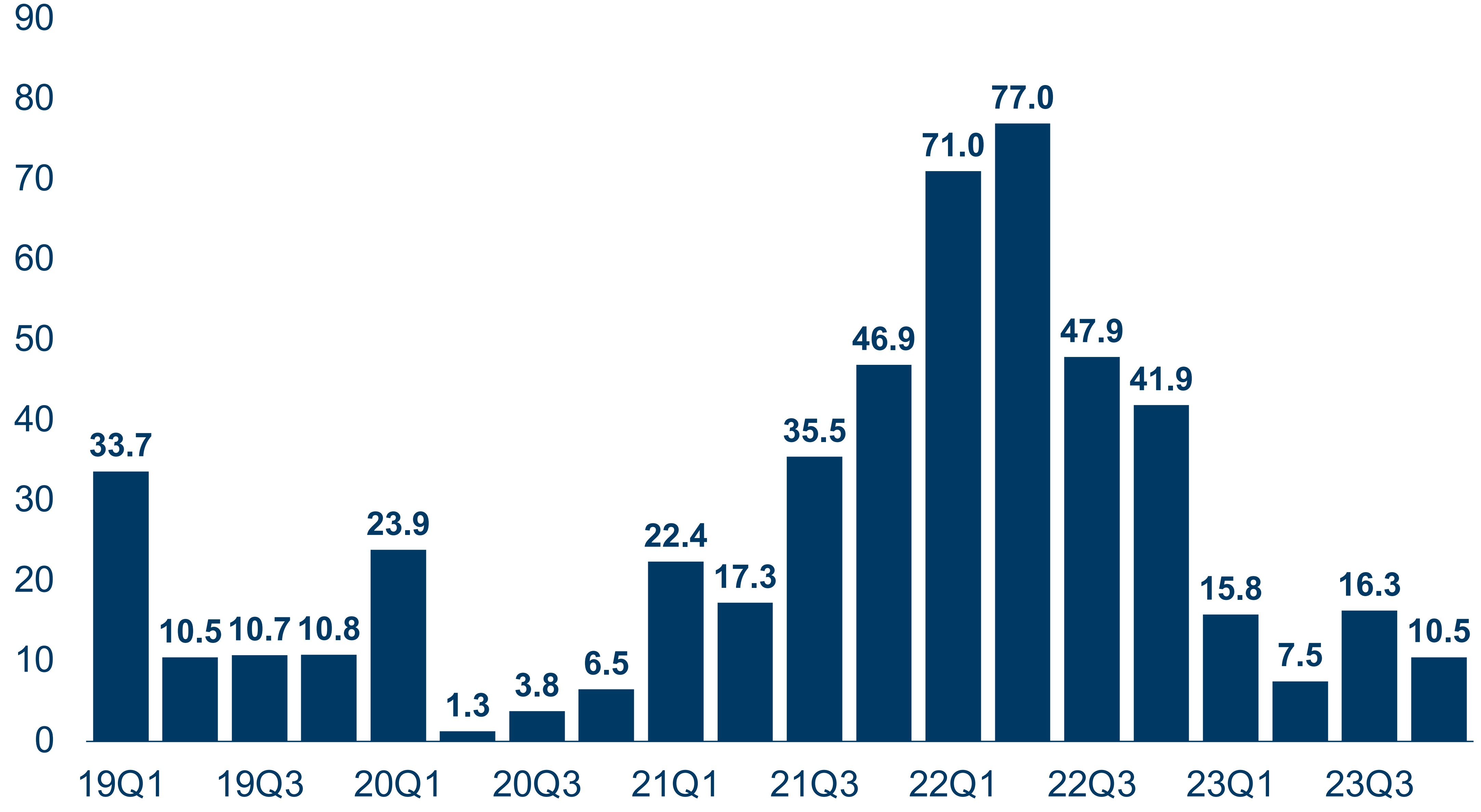
Merchandise trade continues to show substantial weakness.

- The 2023 current account surplus reached $50.0 billion—79% lower than the record-high 2022 reading of $238.0 billion.
- In January-February, the surplus increased moderately on the back of smaller services and income & transfers deficits.
- Weaker goods exports are largely offset by smaller imports but show a fundamentally challenging external environment.

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.
Oct. 2023	5.1	10.6	34.2	23.5	-2.3	3.3	5.6	-3.3	3.3	6.6
Nov. 2023	5.0	9.2	33.6	24.4	-1.8	3.3	5.1	-2.4	3.0	5.3
Dec. 2023	0.4	10.9	38.6	27.6	-4.1	4.5	8.6	-6.4	4.2	10.6
Q4 2023	*10.5*	*30.7*	*106.4*	*75.6*	*-8.2*	*11.1*	*19.3*	*-12.1*	*10.5*	*22.5*
Jan. 2024	4.5	7.8	28.9	21.0	-1.9	3.2	5.1	-1.4	3.2	4.6
Feb. 2024	5.2	9.1	31.9	22.8	-1.4	3.0	4.4	-2.6	3.1	5.7
Jan.-Feb. 2024	*9.7*	*17.0*	*60.8*	*43.8*	*-3.3*	*6.2*	*9.5*	*-4.0*	*6.3*	*10.3*
Memorandum										
2021	*122.1*	*190.3*	*494.4*	*304.0*	*-20.4*	*55.6*	*75.9*	*-47.8*	*96.3*	*144.1*
2022	*238.0*	*315.6*	*592.1*	*276.5*	*-22.2*	*48.6*	*70.9*	*-55.3*	*51.5*	*106.8*
Oct. 2022	12.8	18.9	44.1	25.2	-3.4	3.4	6.8	-2.7	4.4	7.1
Nov. 2022	14.2	18.8	45.1	26.3	-2.0	3.8	5.8	-2.6	4.0	6.6
Dec. 2022	14.7	25.1	54.8	29.7	-3.0	5.1	8.1	-7.4	5.8	13.2
Q4 2022	*41.7*	*62.8*	*144.0*	*81.2*	*-8.4*	*12.3*	*20.7*	*-12.7*	*14.2*	*26.9*
Jan. 2023	5.4	9.5	33.6	24.1	-2.4	3.2	5.6	-1.7	3.5	5.2
Feb. 2023	3.0	8.2	30.7	22.5	-2.1	3.2	5.3	-3.1	3.8	6.9
Jan.-Feb. 2023	*8.5*	*17.7*	*64.3*	*46.6*	*-4.5*	*6.4*	*10.9*	*-4.7*	*7.3*	*12.0*

Source: Bank of Russia, KSE Institute

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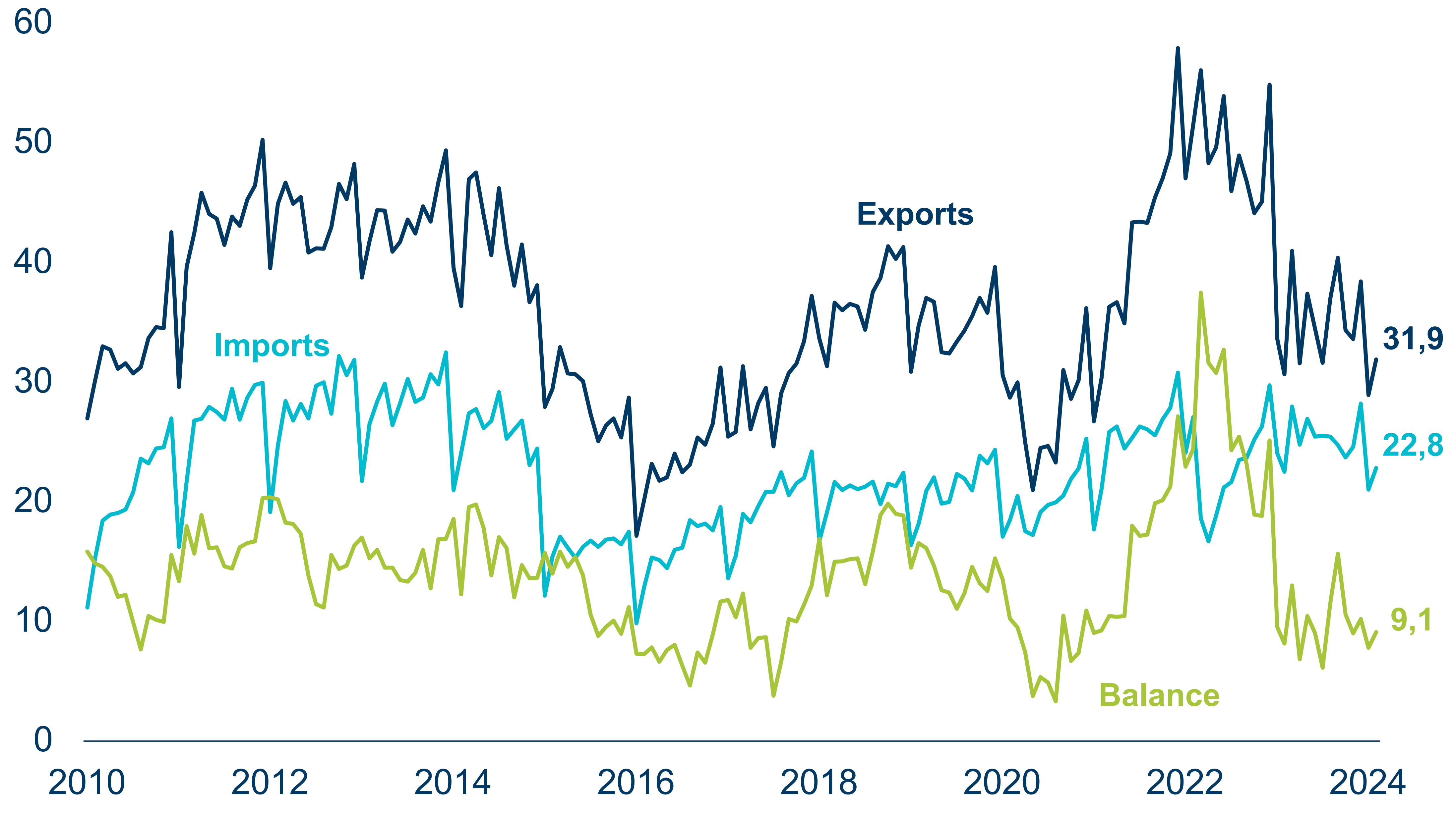
Foreign trade has settled in at a new post-full scale invasion baseline.

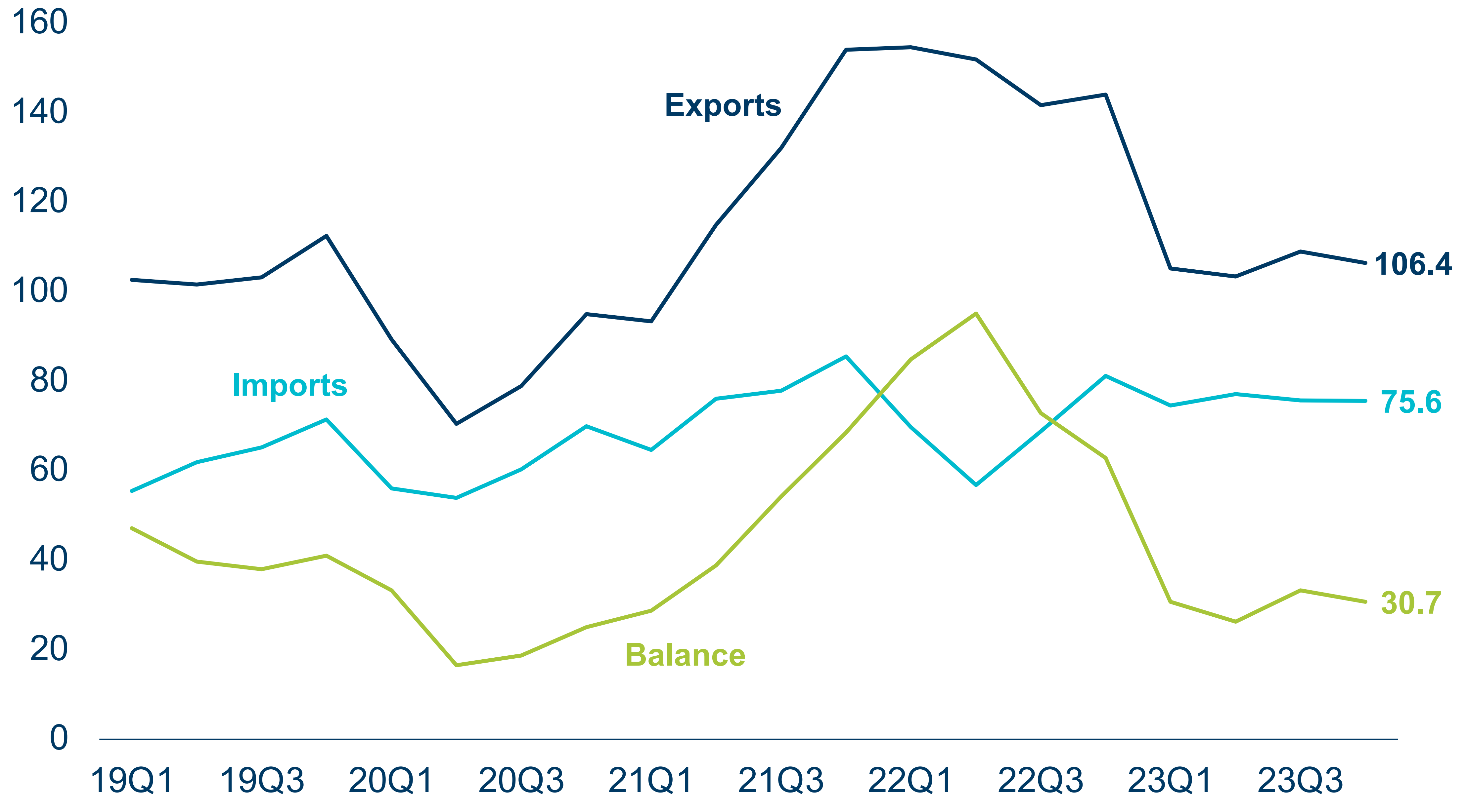
- Russia's foreign trade has stabilized at a new baseline of ~$100 billion in exports and ~$75 billion in imports per quarter.
- Fundamentally, sanctions and moderating commodity prices have fully reversed the exports boom late 2021 and 2022.
- However, to push Russia's foreign currency inflows to a critically-low level this year and beyond, more action is needed.

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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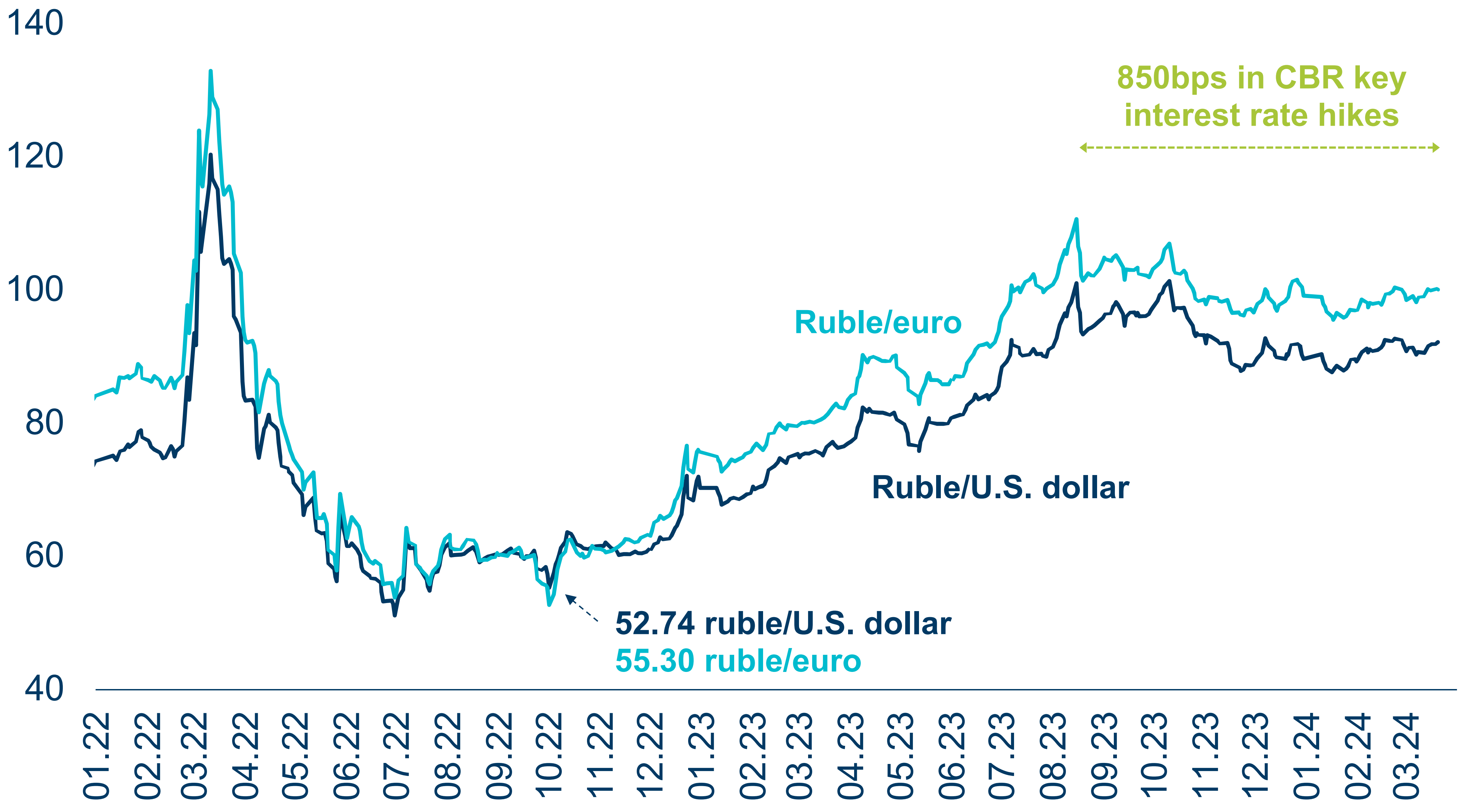
Ruble has stabilized, but future CBR approach unclear.

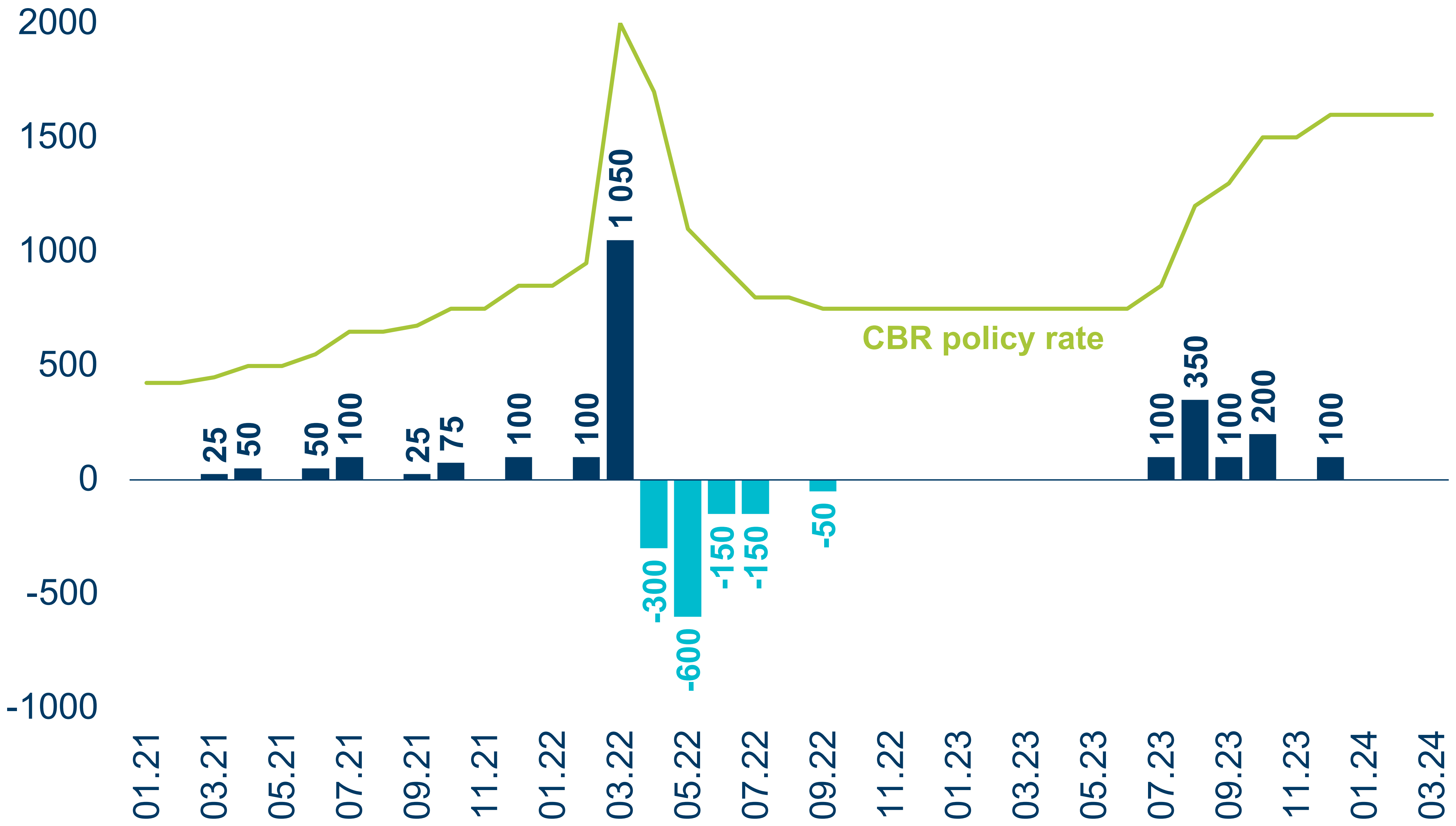
- Since October 2022, the ruble has lost ~43% of its value against the U.S. dollar and ~45% against the euro.
- The re-introduction of capital controls and additional CBR interest rate hikes have led to some stabilization.
- It is possible that the CBR will allow the ruble to depreciate with the presidential “election” now concluded.

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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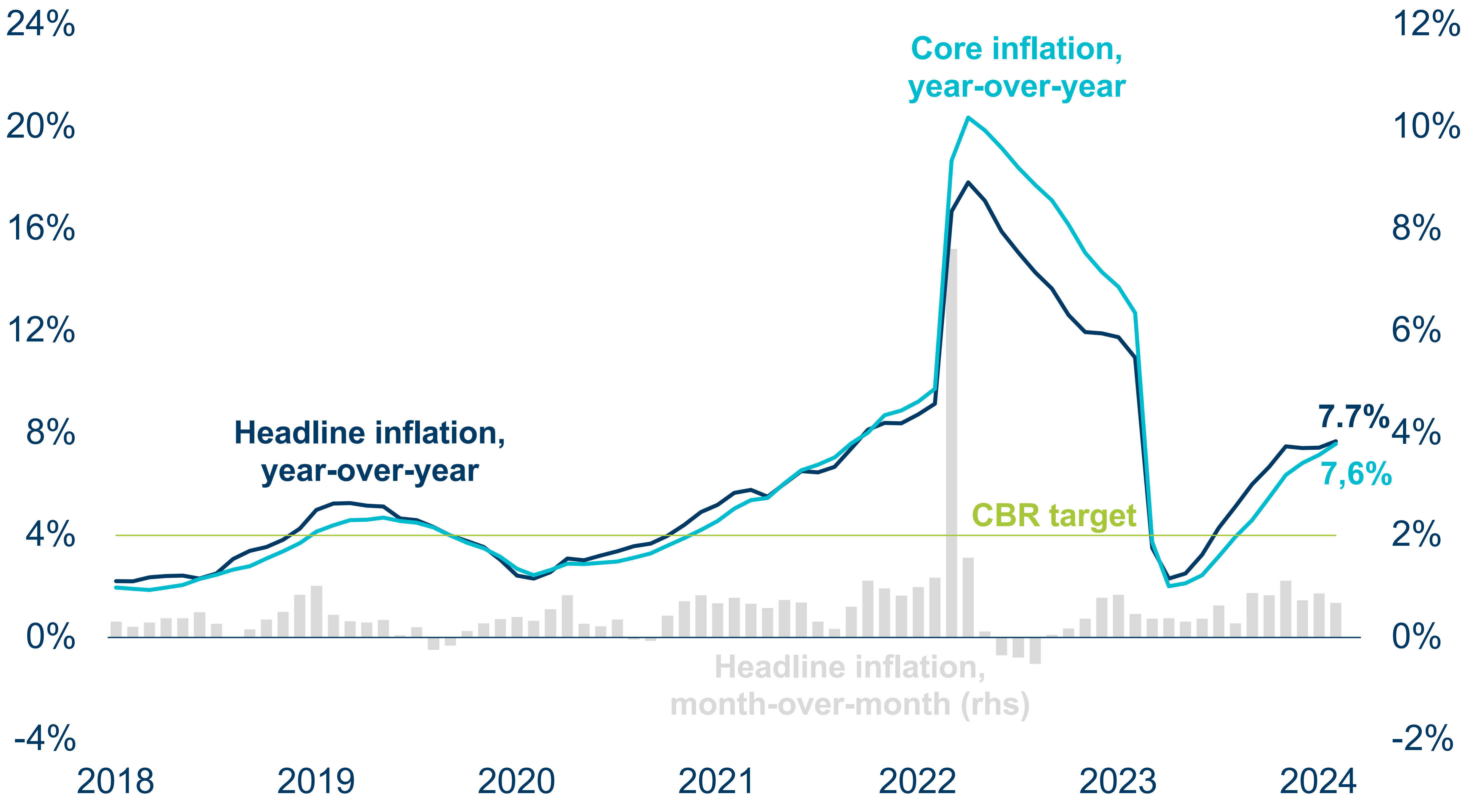
Headline and core inflation continue to rise.

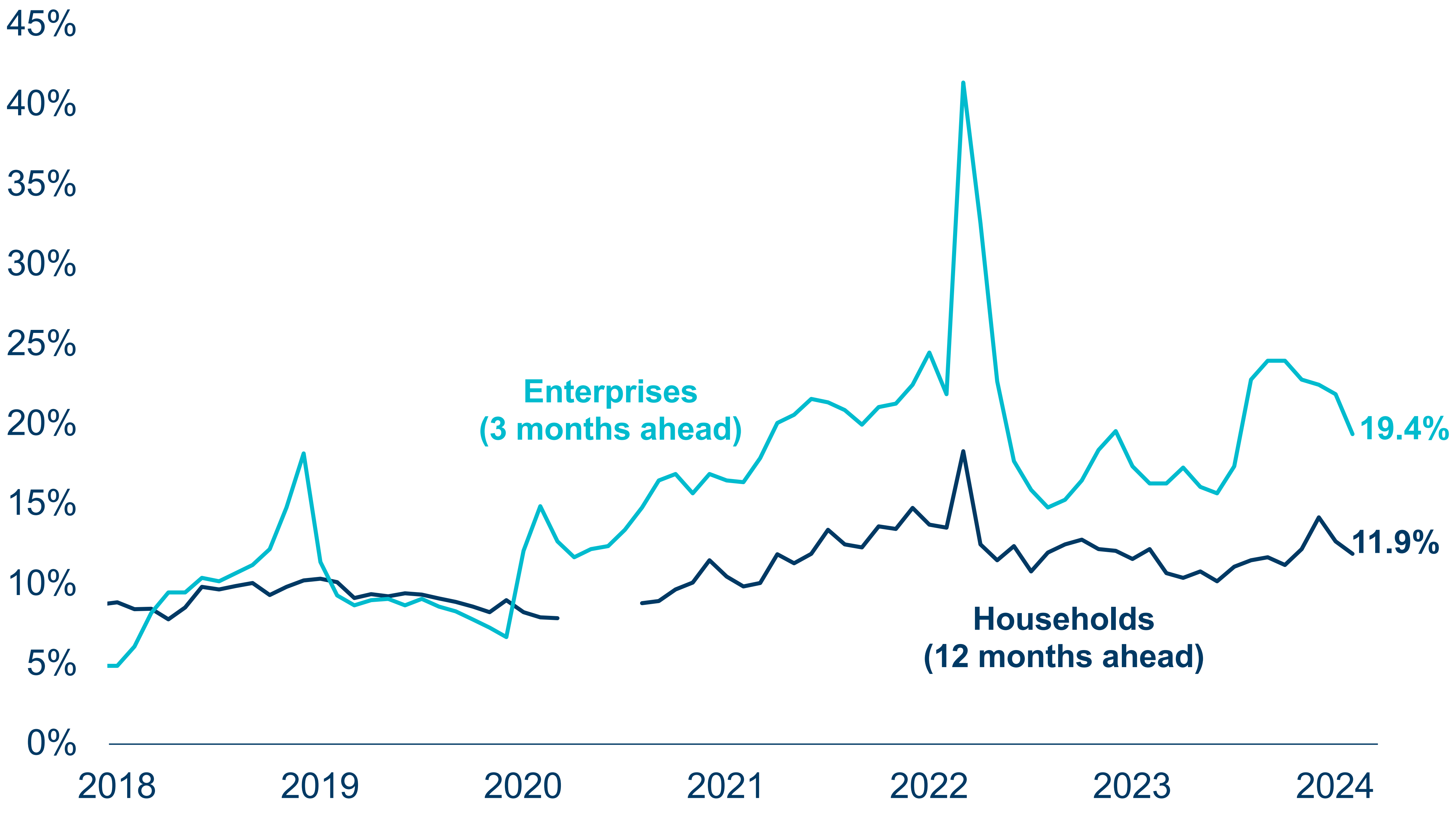
- Following a base effects-driven drop in spring/summer 2023, both headline and core inflation are rising again.
- Based on current month-to-month dynamics, headline inflation will likely reach double-digits again in H2 2024.
- Rising inflation expectations of enterprises also indicate that more CBR action may be needed going forward.

Inflation, in %



Source: Bank of Russia, KSE Institute

Inflation expectations, in %

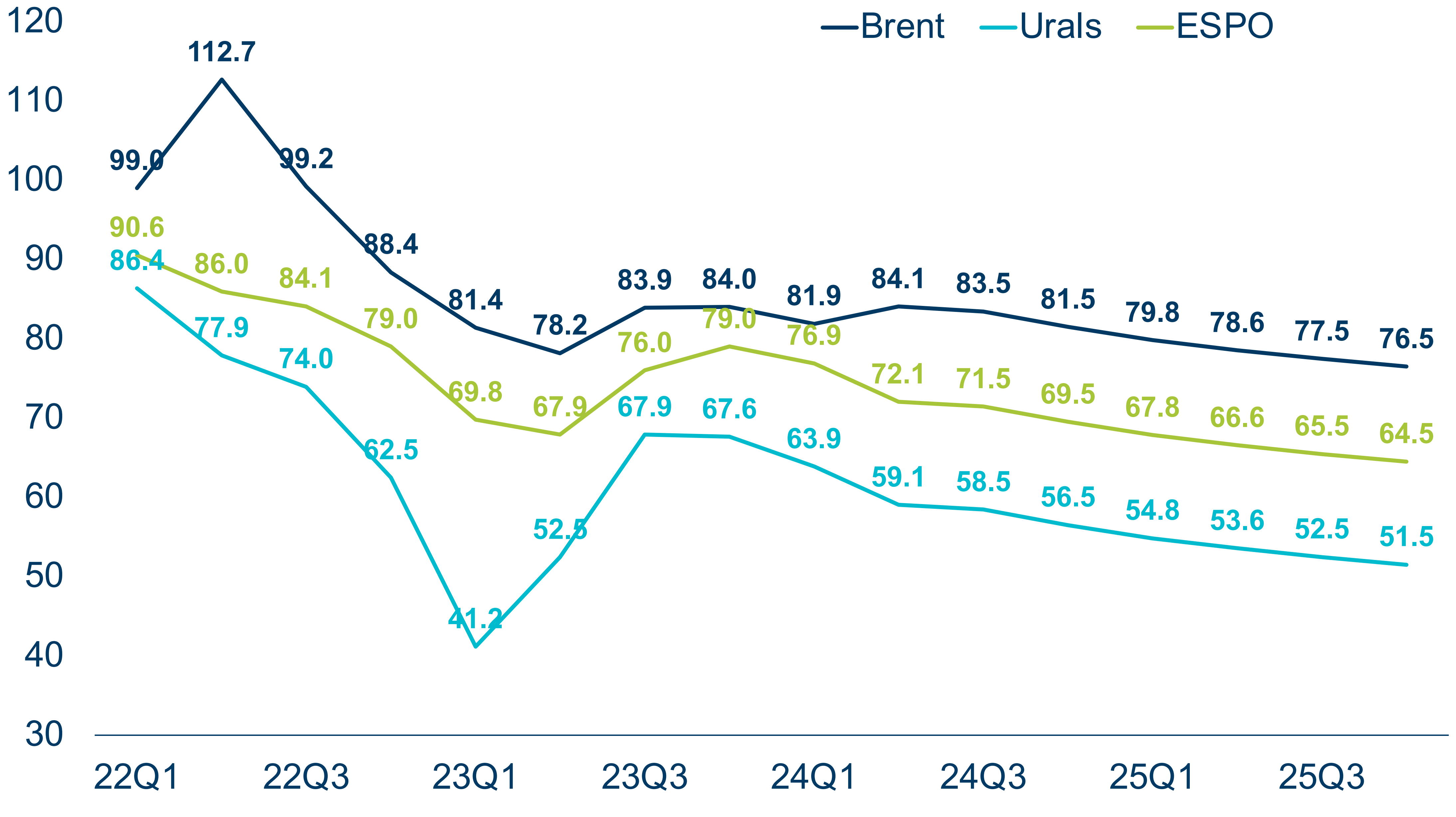


Source: Bank of Russia, KSE Institute

Wider discount on Russian oil to reduce export earnings in H2 2024.

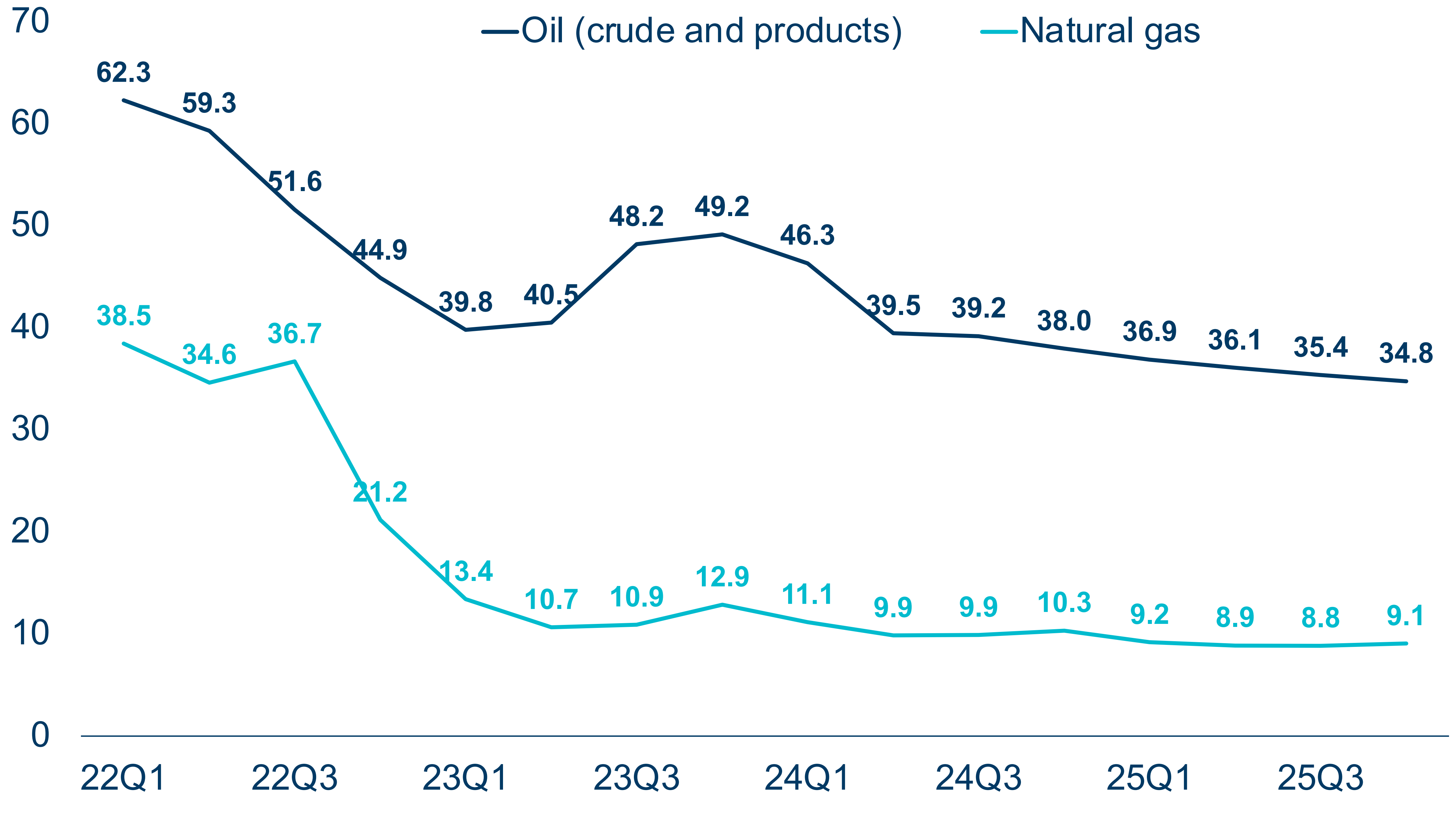
- In our base case, Urals and ESPO discounts vs. Brent will widen in H2 2024 as price cap enforcement is stepped up.
- This would offset higher global oil prices and reduce Russia's oil export earnings to below $40 billion per quarter.
- Natural gas exports are unlikely to recover from failed weaponization of flows to Europe since the second half of 2022.

Oil prices, in U.S. dollar/barrel



Source: KSE Institute

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

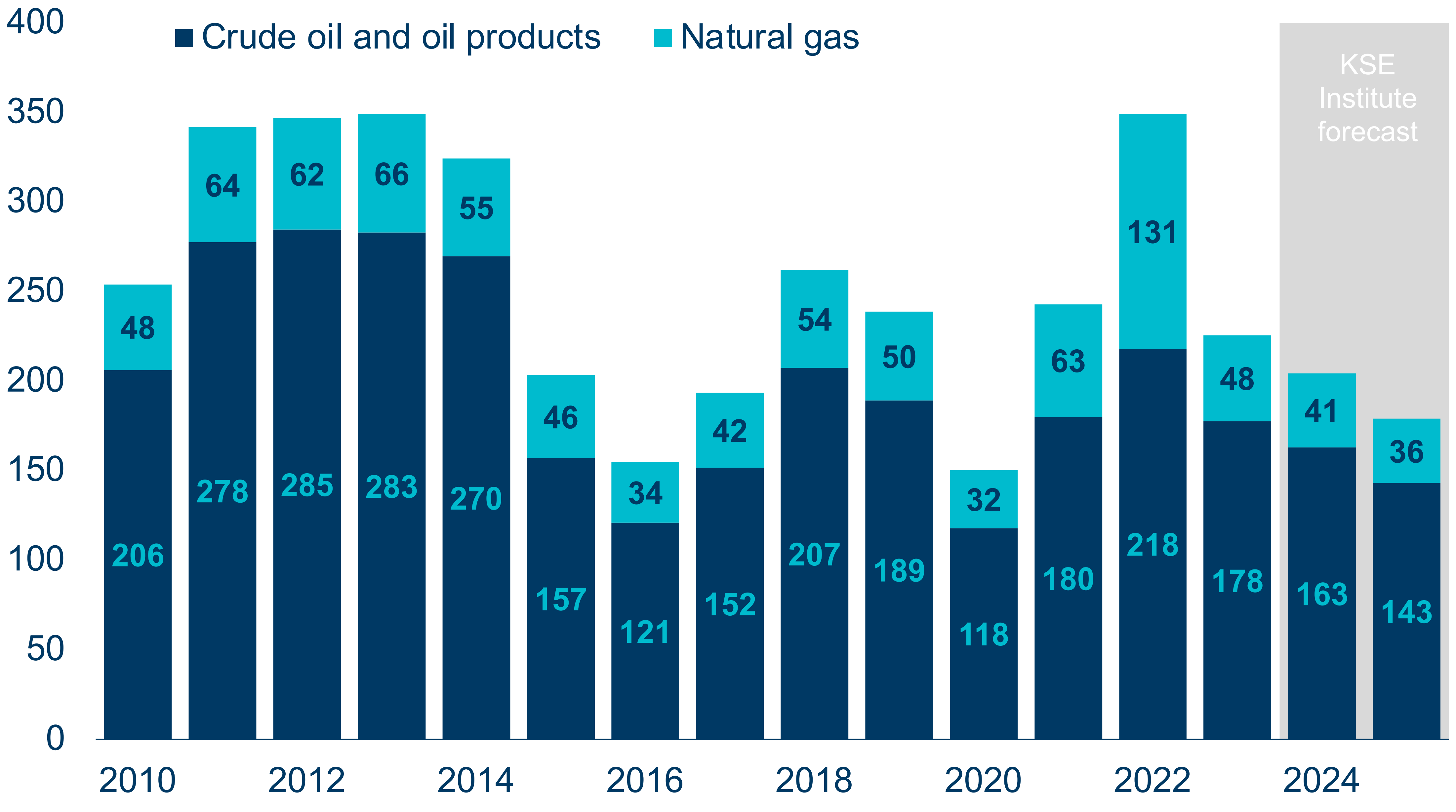


Source: KSE Institute

Current account surplus to remain at or below current level in 2024-25.

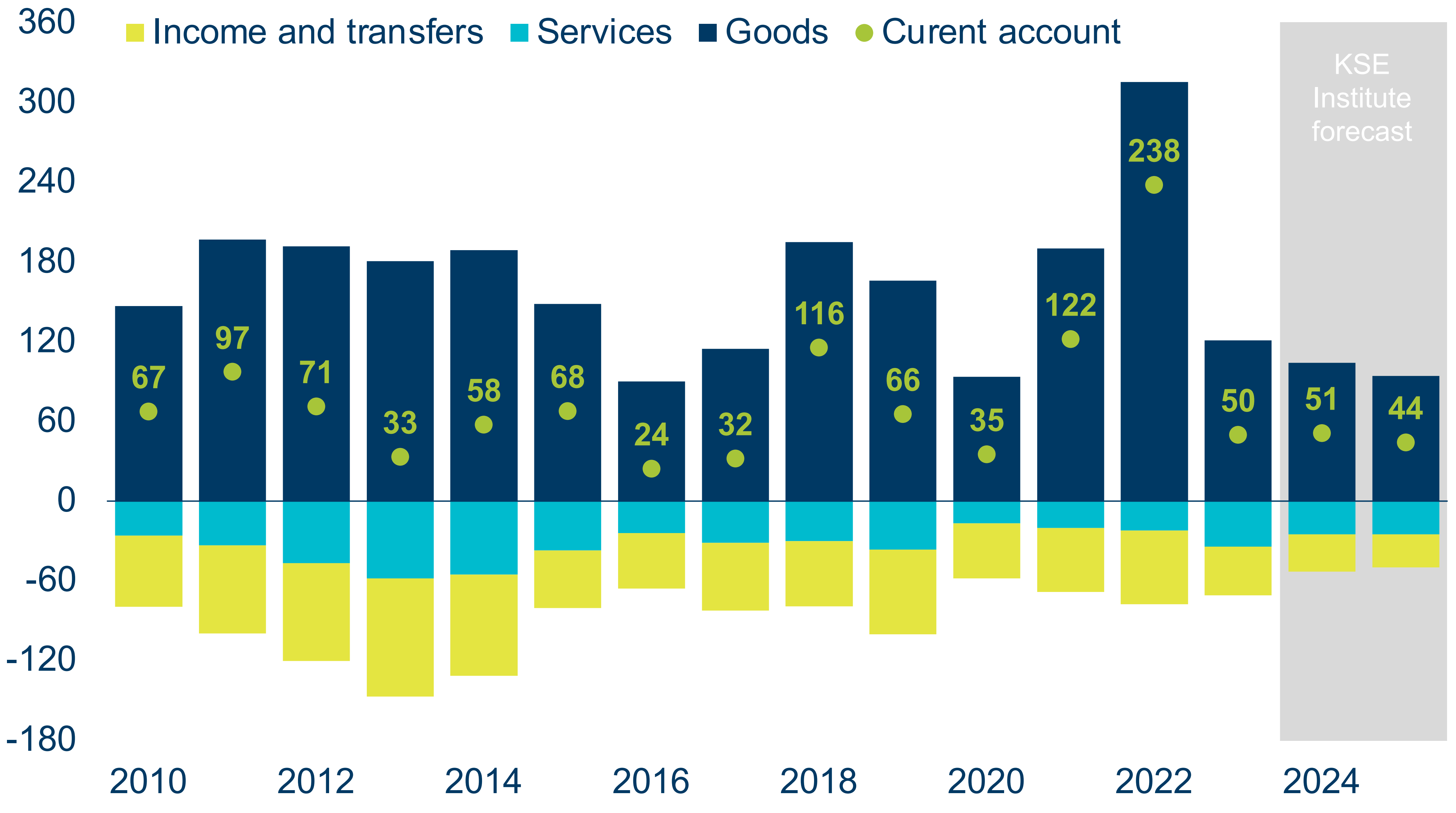
- We assess that oil and gas exports reached $225 billion in 2023 and will drop to $204 billion in 2024, $179 billion in 2025.
- This will weigh on the overall current account, with surpluses of only $51 billion and $44 billion in 2024-25, respectively.
- It is critical to main pressure through sanctions as $10/barrel in oil prices change export earnings by ~$25-30 billion/year.

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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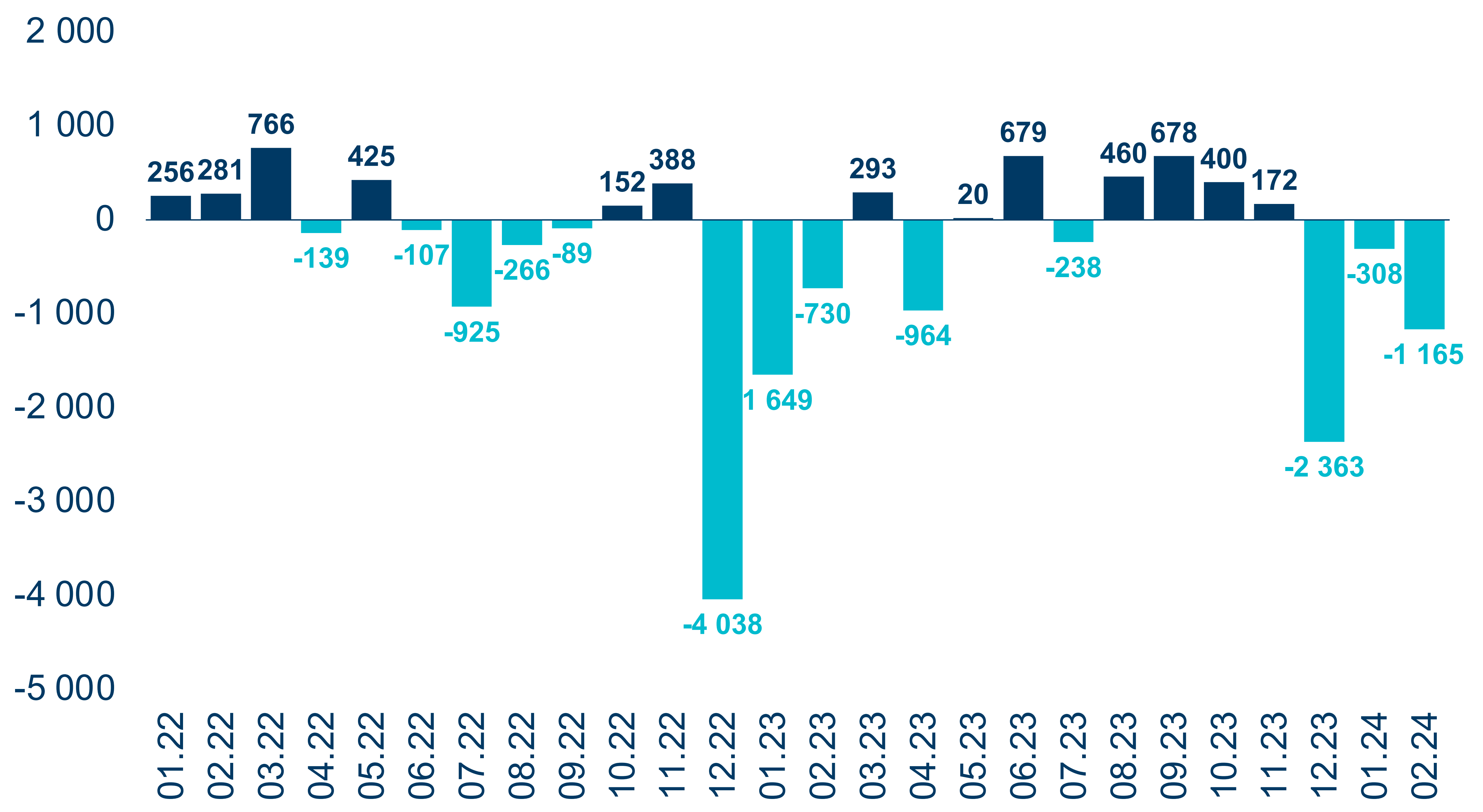
Budget: higher spending in January-February drives up deficit to 92% of full-year plan; Russia considers 4 trillion rubles tax increase.

Sharp rise in spending drives up deficit to 92% of full-year plan.

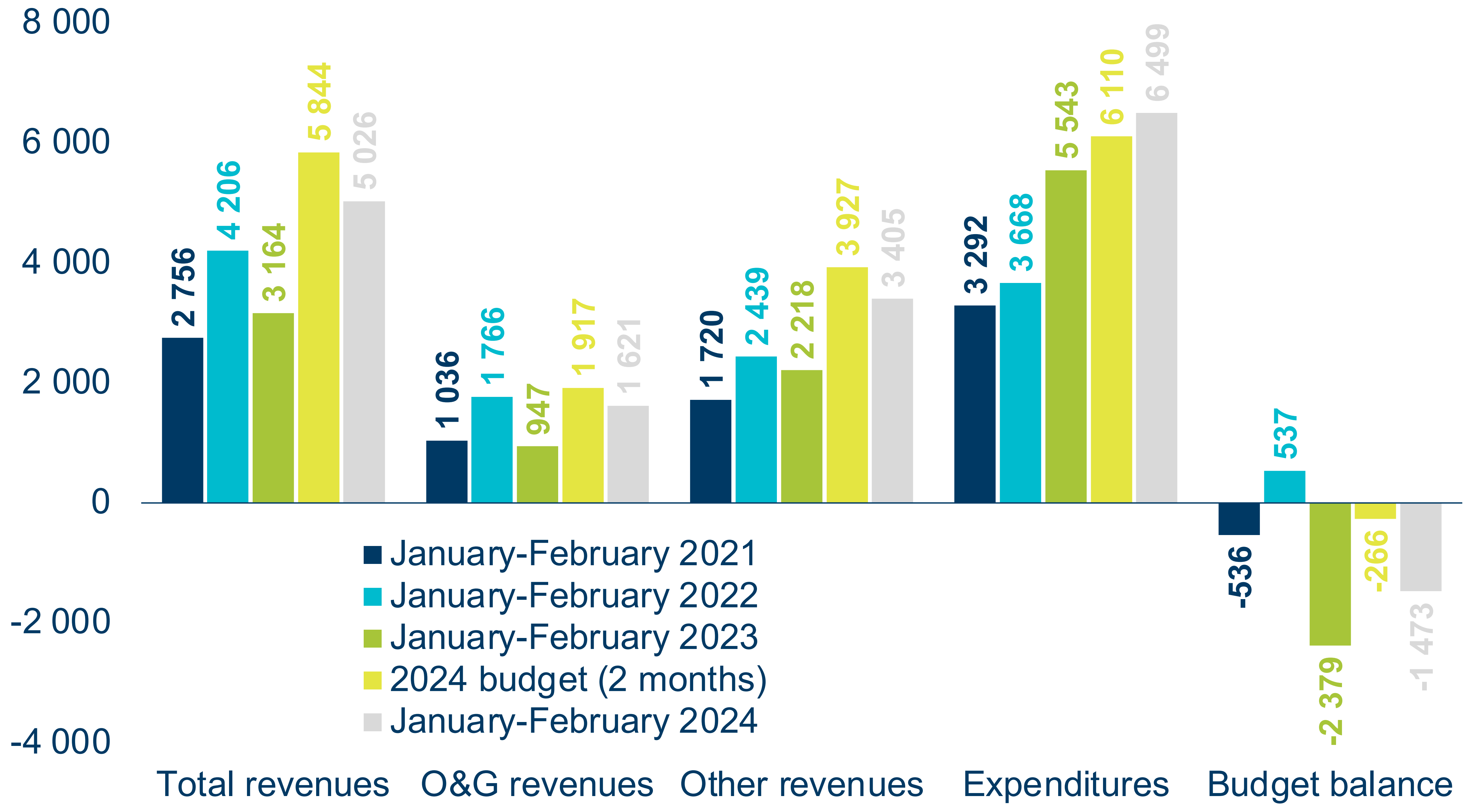
- In January-February 2024, Russia's federal budget deficit reached 1.5 trillion rubles, 92% of the full-year plan.
- O&G revenues were 71%, non-O&G revenues 54%, and expenditures 17% higher vs. January-February 2023.
- Due to uncertainty about future revenues, Russia plans to raise some income and corporate taxes by 4 trillion.

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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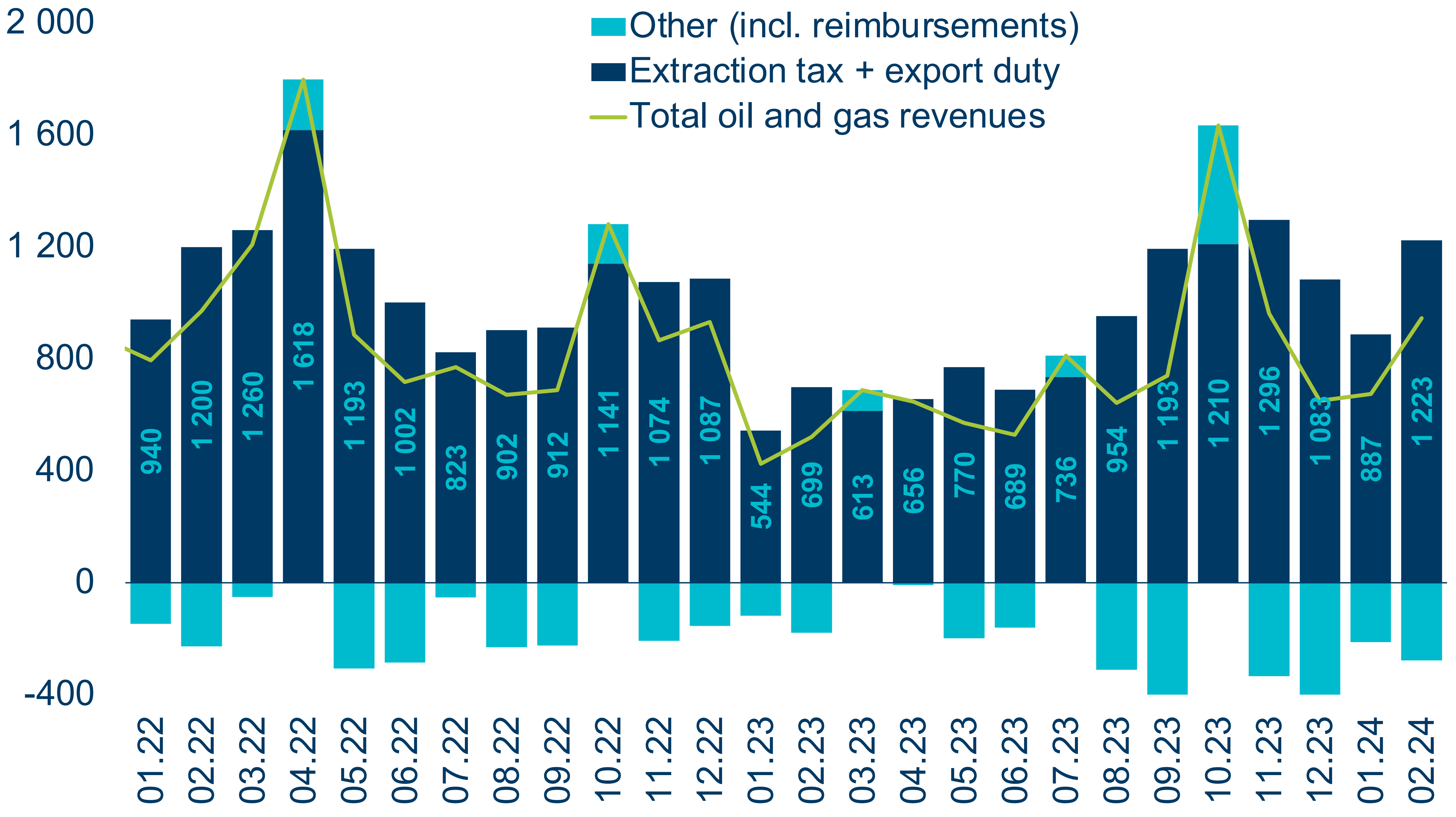
Russia's oil and gas revenues grew in February.

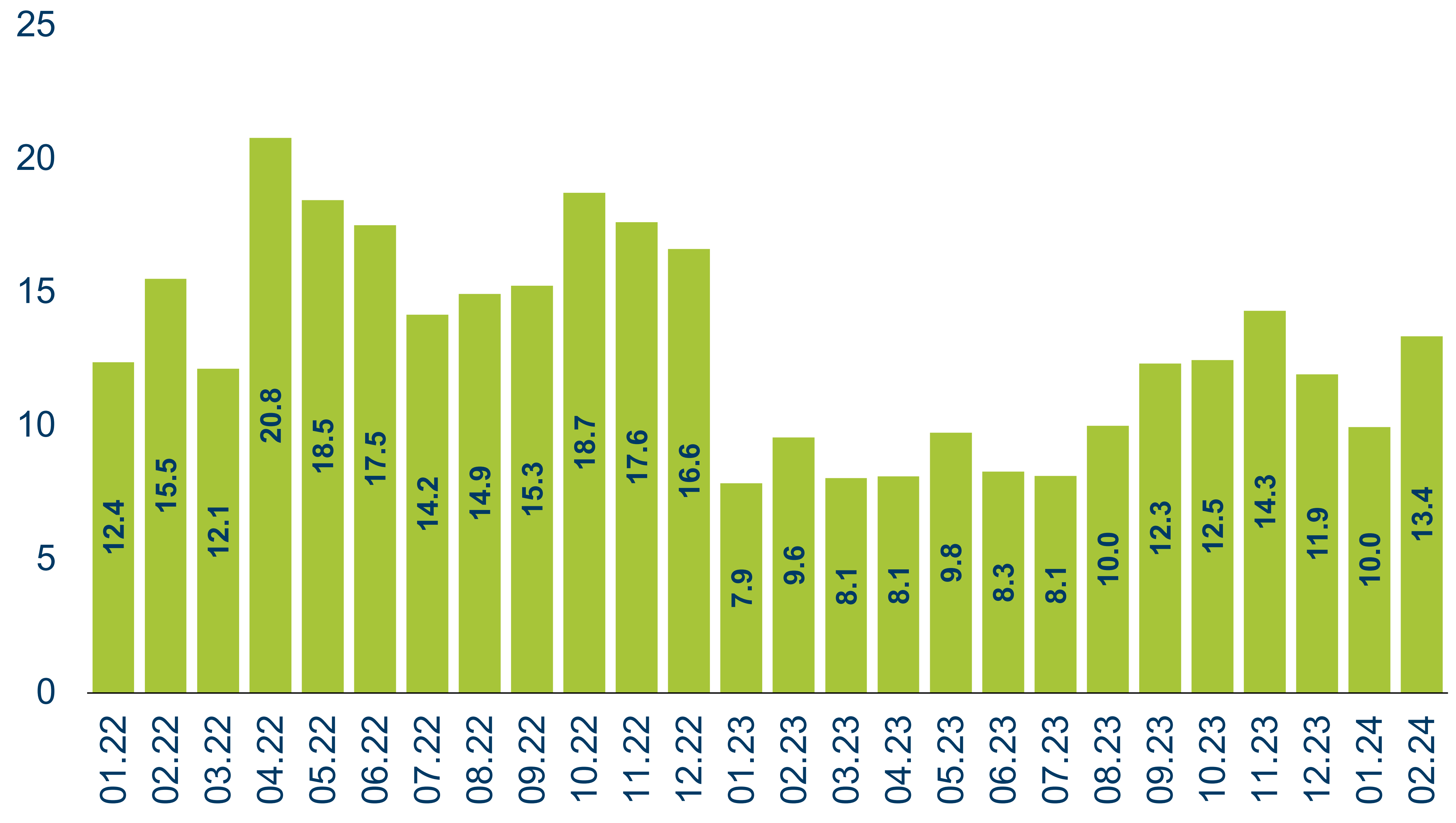
- Oil and gas budget revenues rebounded in February 2024, largely due to the changes to the tax regime.
- While the weaker ruble supported the budget in the second half of 2023, revenues also rose in dollar terms.
- Ukrainian attacks on refineries and a temporary ban on gasoline may affect revenues in coming months.

Federal oil and gas revenues, in ruble billion



Source: Ministry of Finance, KSE Institute

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

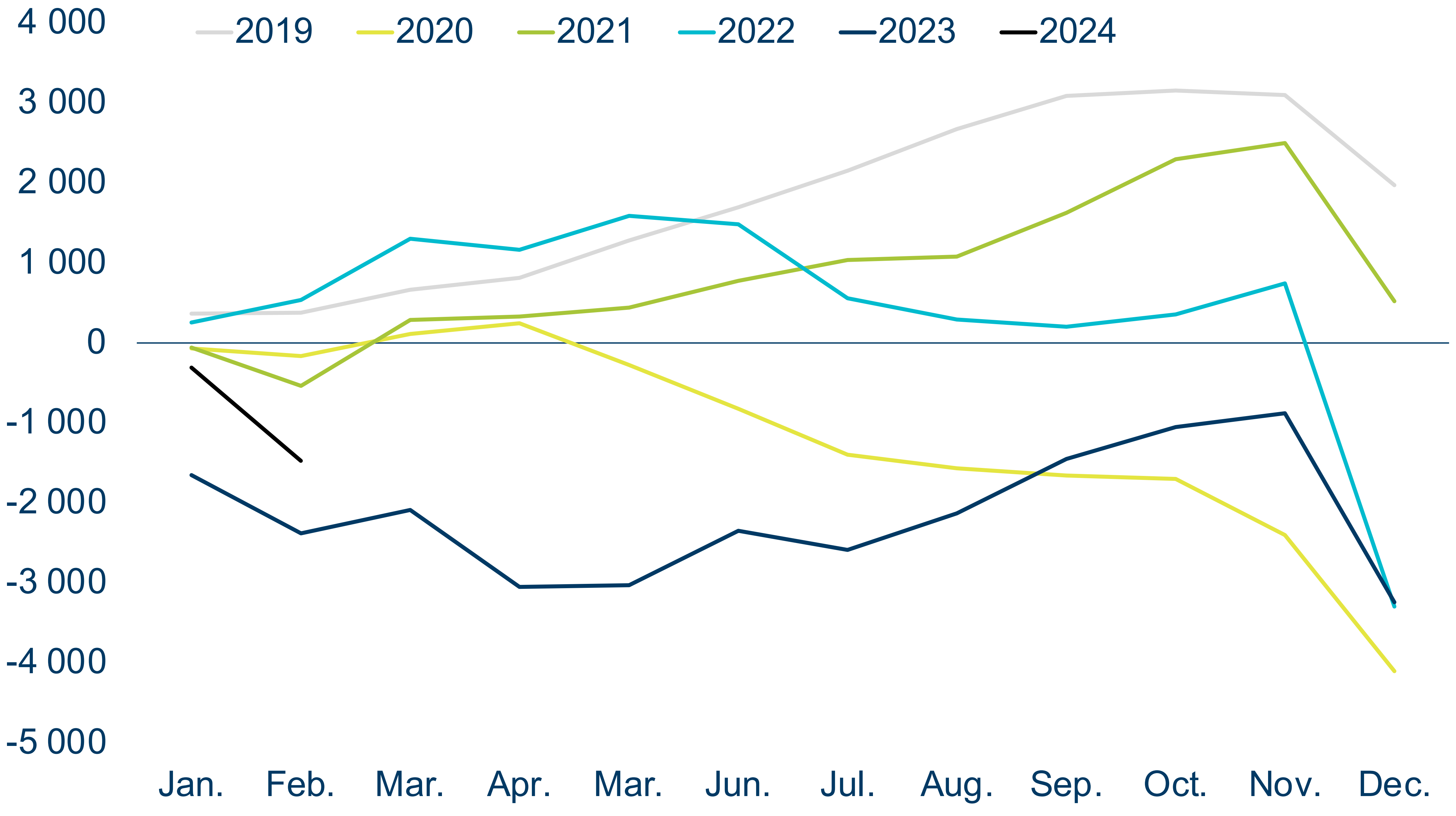


Source: International Monetary Fund, Ministry of Finance, KSE Institute
*includes extraction tax and export duty; calculated with monthly average exchange rate

Russia's government will likely contain the deficit—but at what price?

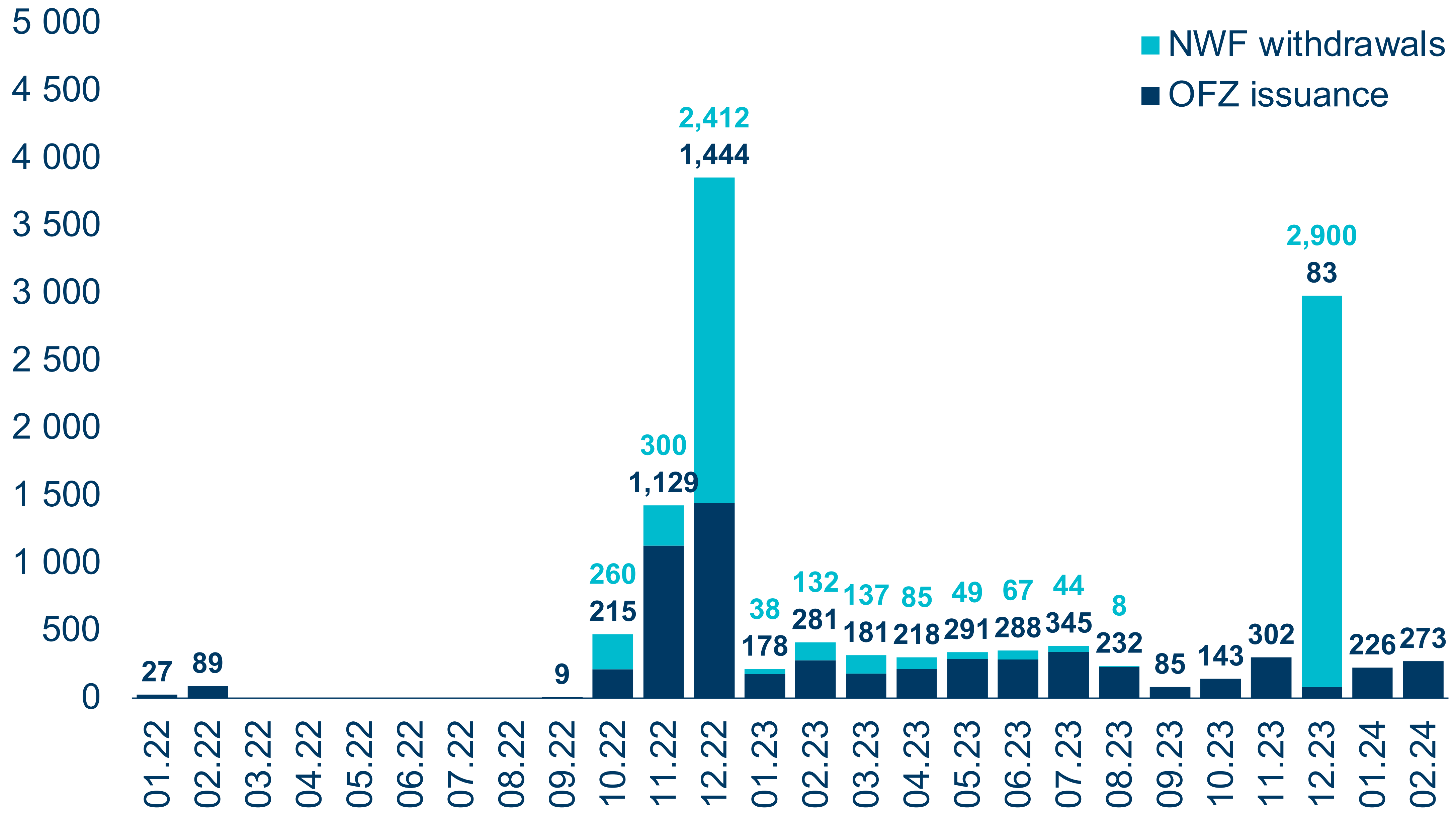
- While the January-February deficit is smaller in 2024 than last year, expenditures are up sharply due to the war.
- The Russian government has demonstrated a willingness and ability to consolidate public finances in the past.
- However, keeping the deficit contained will require tax increases and/or meaningful cuts to non-military spending.

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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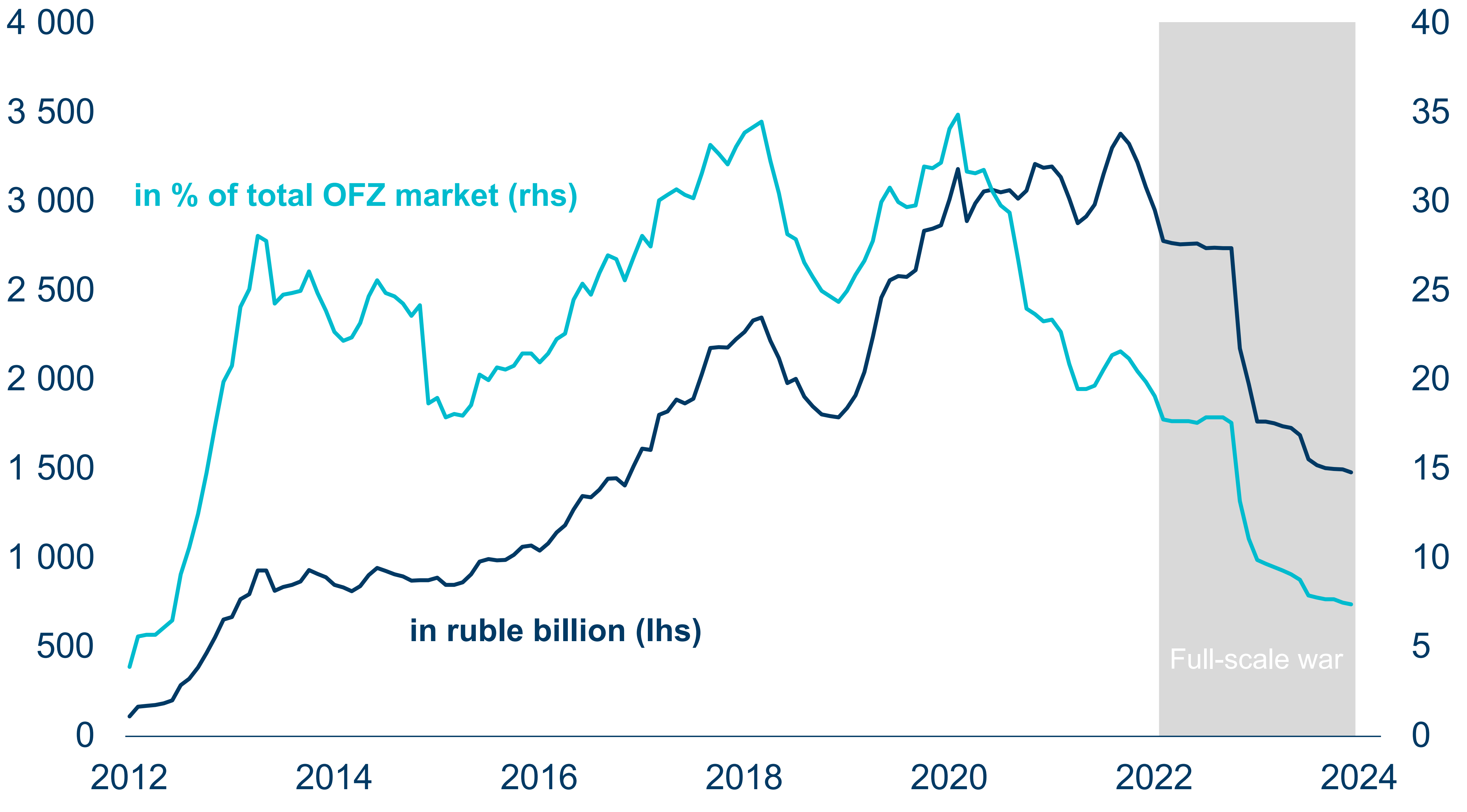
Domestic banks are the only remaining buyers for OFZs.

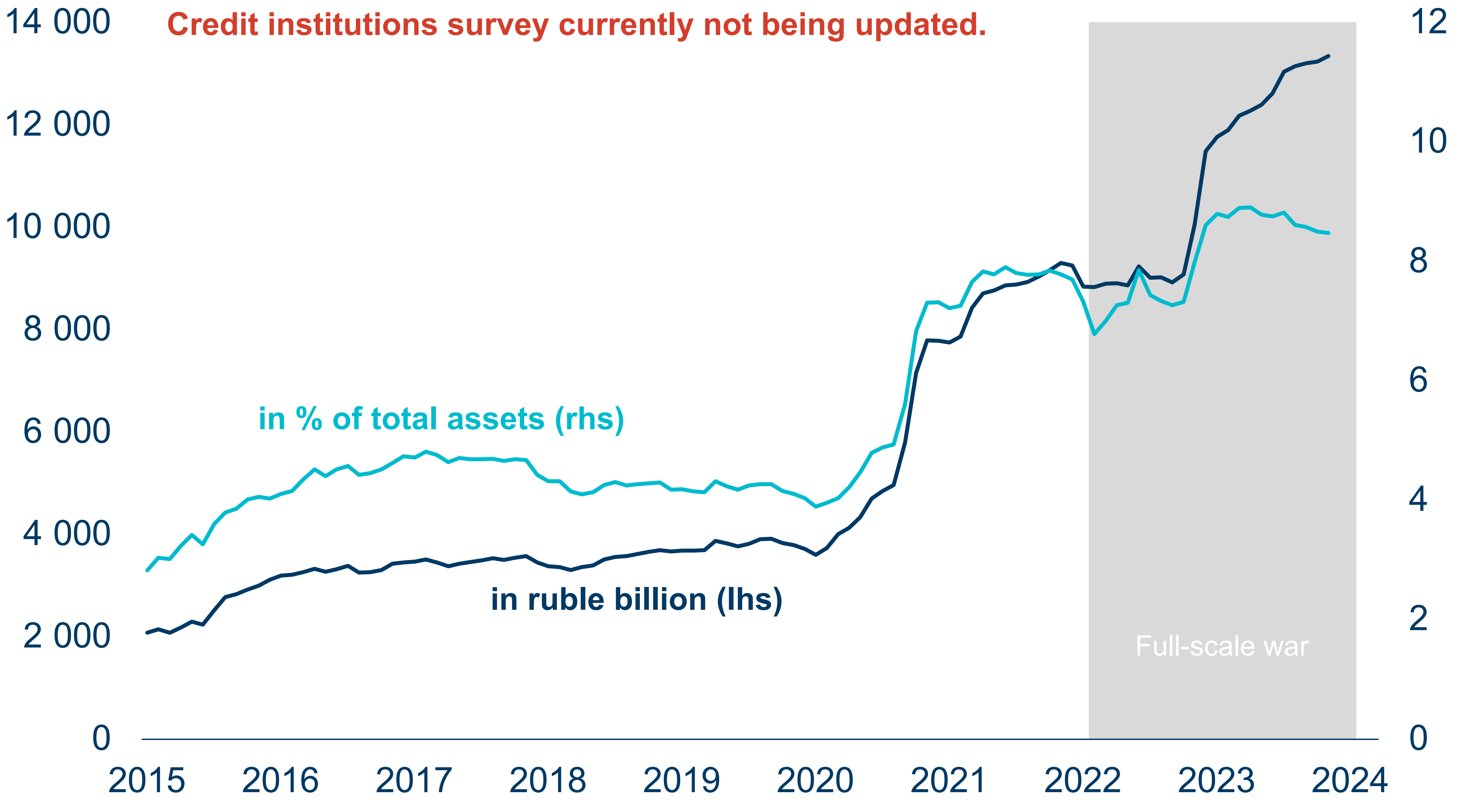
- Foreigners have largely disengaged from the Russian sovereign debt market since the start of the war.
- Non-resident holdings have dropped 1.3 trillion rubles (or 46%) since October 2022 as bonds matured.
- Over the same period, credit institutions’ holdings have risen by close to 4.3 trillion rubles (or 47%).

Non-resident OFZ holdings



Source: Bank of Russia, KSE Institute

Credit institutions OFZ holdings



Source: Bank of Russia, KSE Institute

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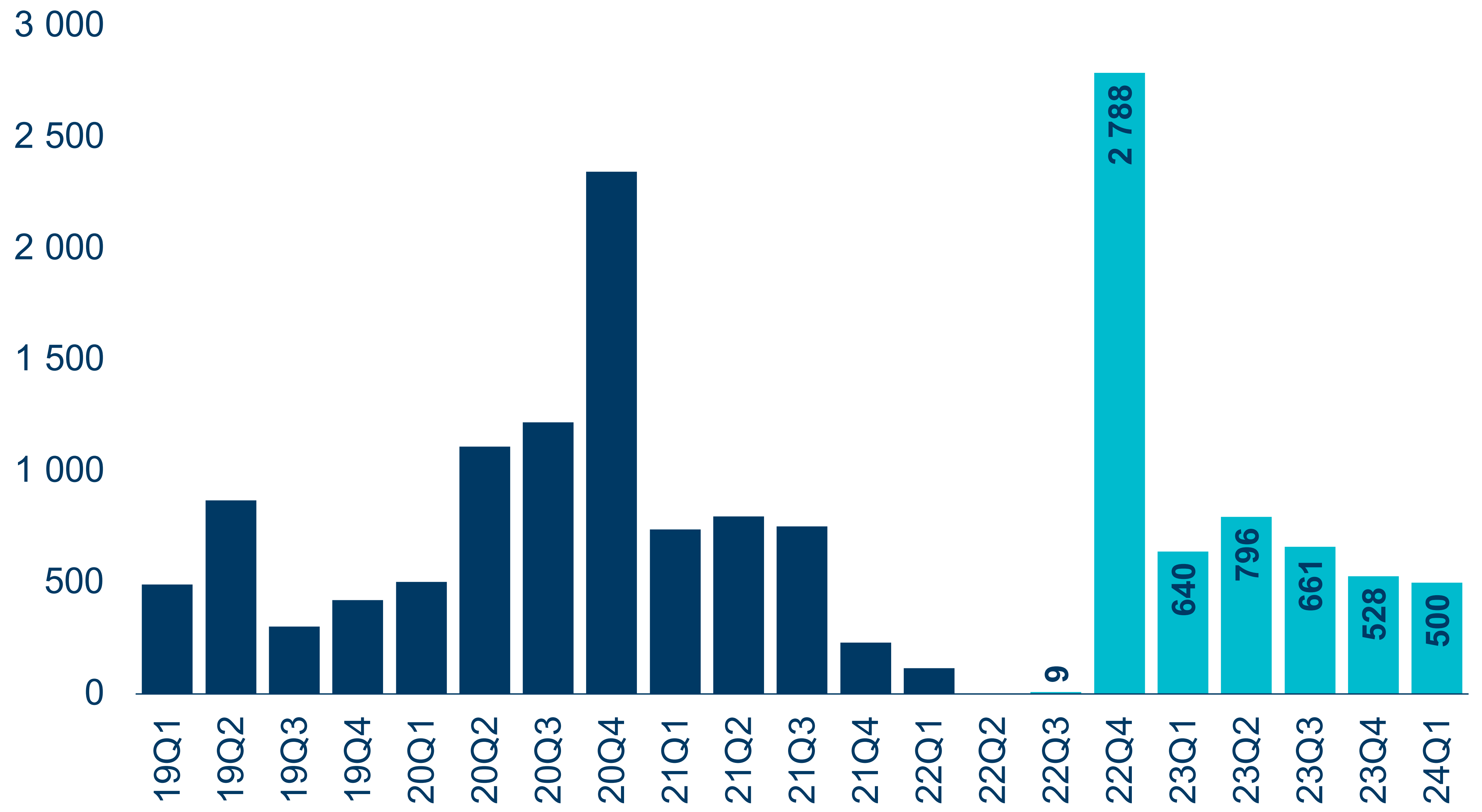
Concerns over macroeconomic management drive up bond yields.

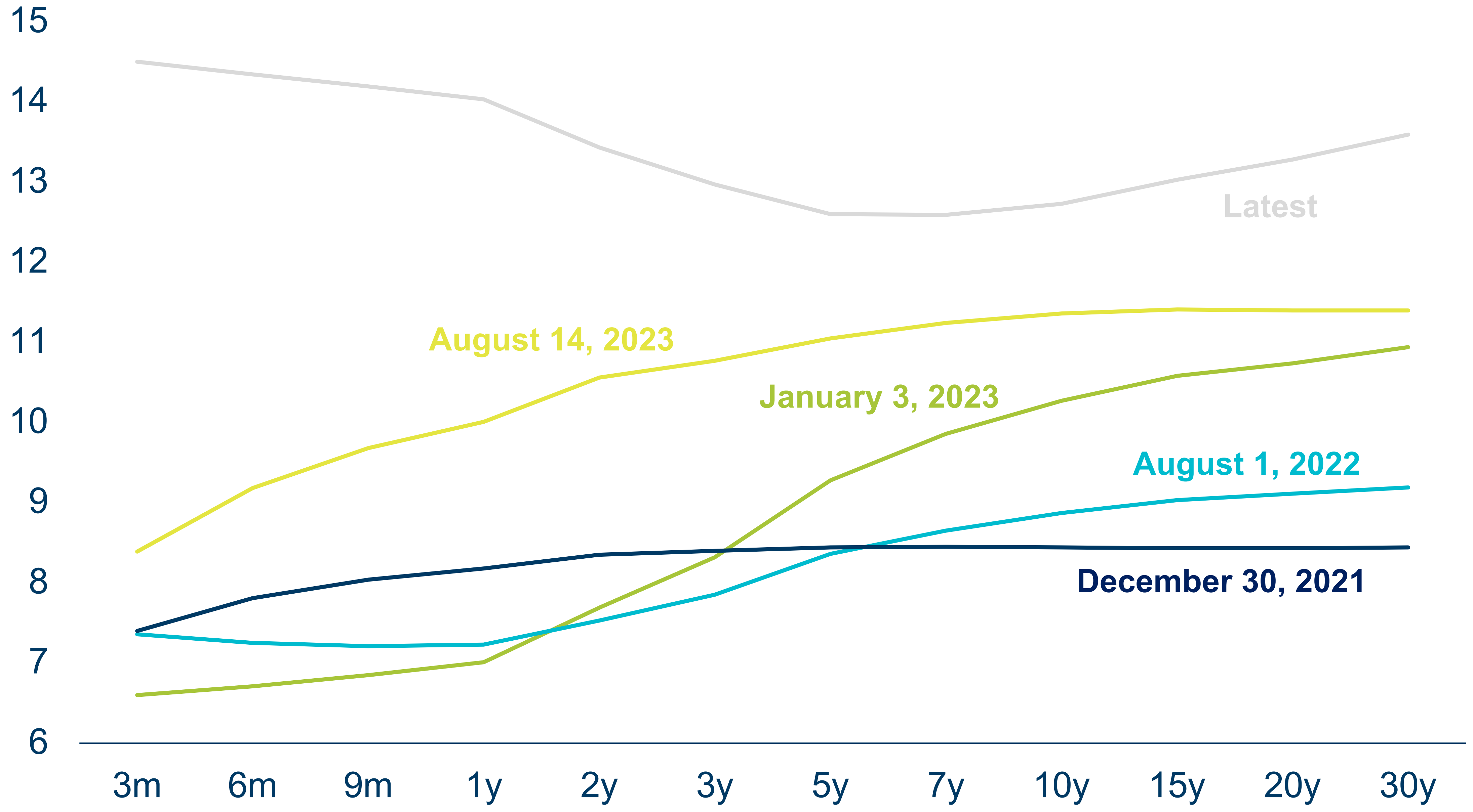
- The OFZ yield curve reflects the recent CBR rate hikes (of cumulative 850bps) with the short end shifting up sharply.
- Significantly higher rates for shorter maturities also reflect concerns about the future course of economic management.
- Specifically, it is possible that the CBR will allow the ruble to depreciate after the presidential “elections” are concluded.

New domestic debt (OFZ) issuance, in ruble billion



Source: Ministry of Finance, KSE Institute

OFZ yield curves, in %



Source: Bank of Russia, KSE Institute

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Macro buffers: Russia has used up half of the NWF’s liquid assets; access to reserves seriously constrained.

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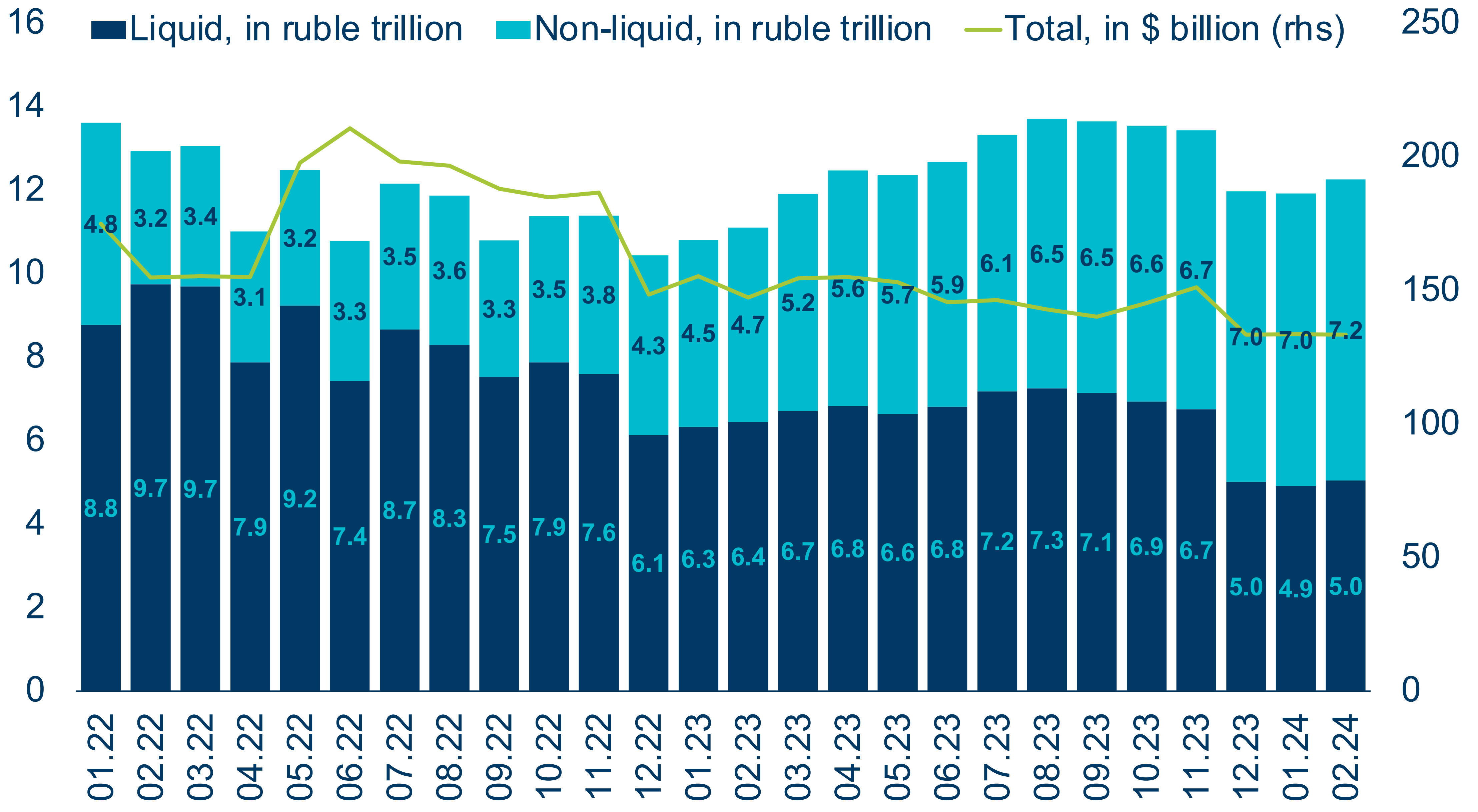
Half of the NWF's liquid assets have been used up.

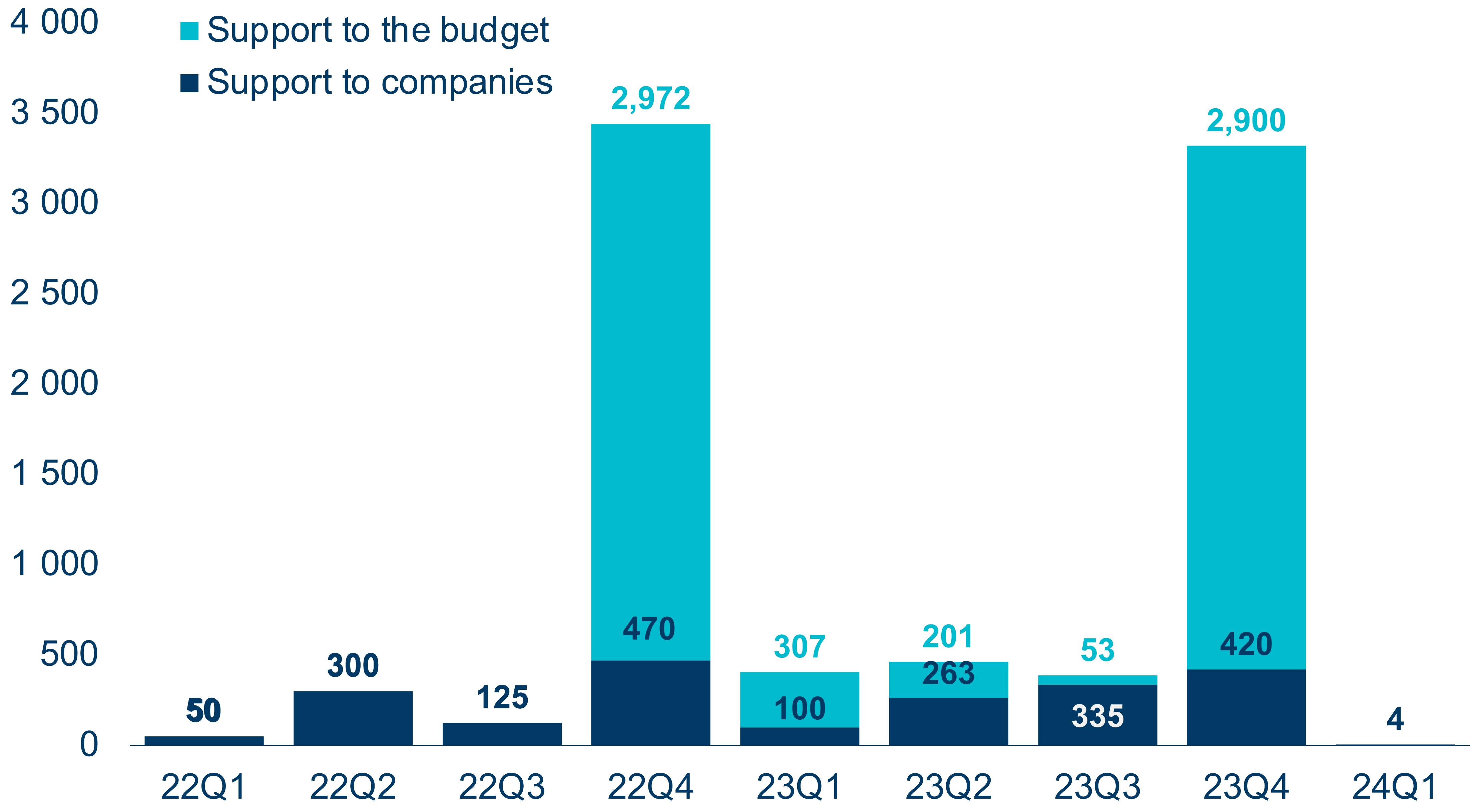
- Total assets of the National Welfare Fund stood at 12.3 trillion rubles ($133.4 billion, 6.8% of GDP) in February 2024.
- The liquid portion now only accounts for 41% of the total as funds were withdrawn for budgetary support in December.
- Since the start of the full-scale invasion, Russia has, thus, used up almost half (~4.7 trillion) of the NWF's liquid assets.

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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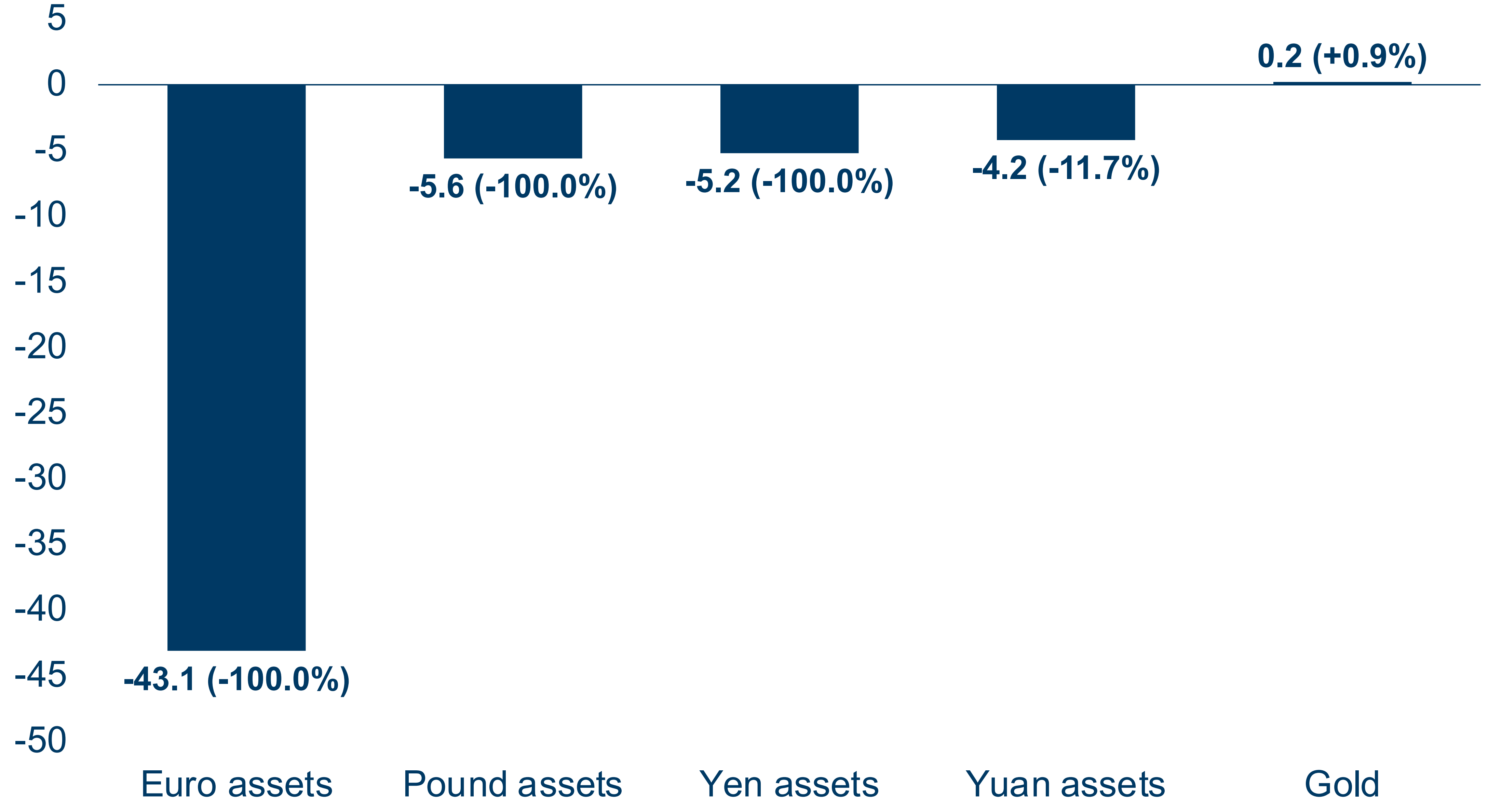
Headline NWF numbers conceal that hard currency assets are gone.

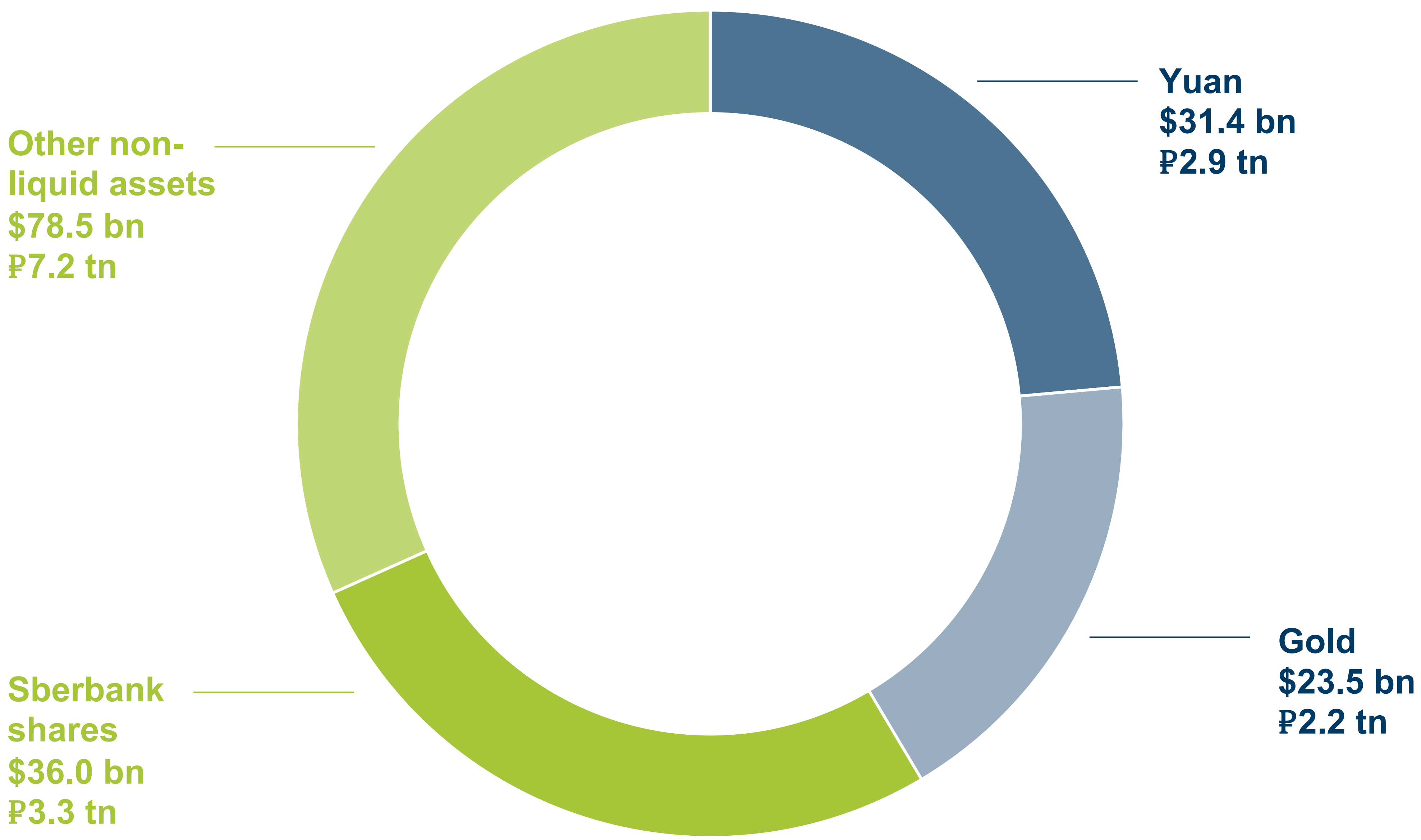
- Russia has depleted all hard-currency holdings of the NWF, with euro assets falling to zero in December 2023.
- Only yuan-denominated assets and gold remain in the liquid portion, totaling 5.0 trillion rubles (or $55 billion).
- As these are more difficult to use, at least at scale, budgetary funding via the NWF will become more challenging.

Change in liquid assets (Feb. 2024 vs. Jan. 2022), in U.S. dollar billion



Source: Ministry of Finance, KSE Institute

Composition of NWF assets as of March 1, 2024*

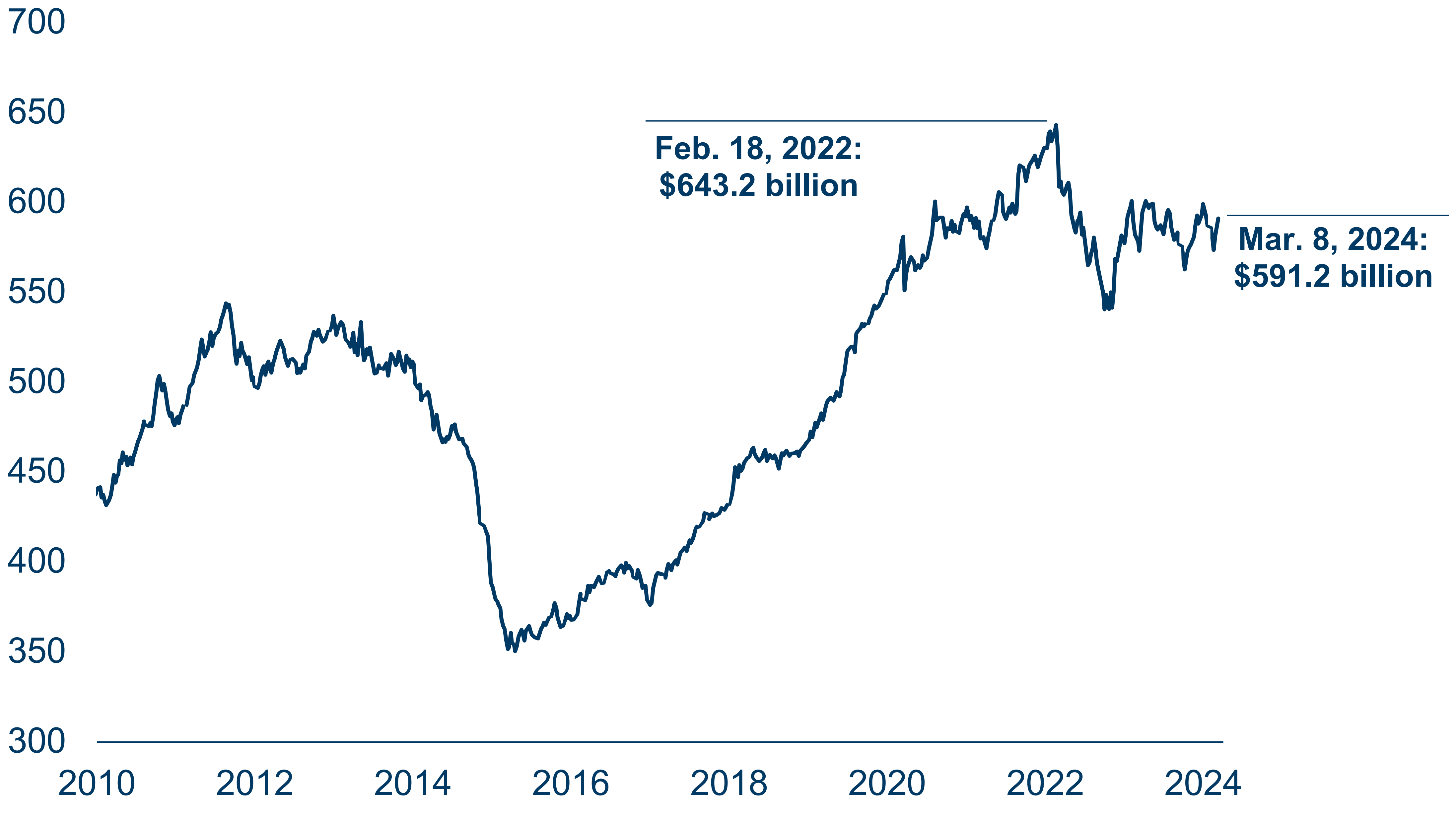


Source: Ministry of Finance, KSE Institute *based on market exchange rates/prices

A substantial share of international reserves remain immobilized.

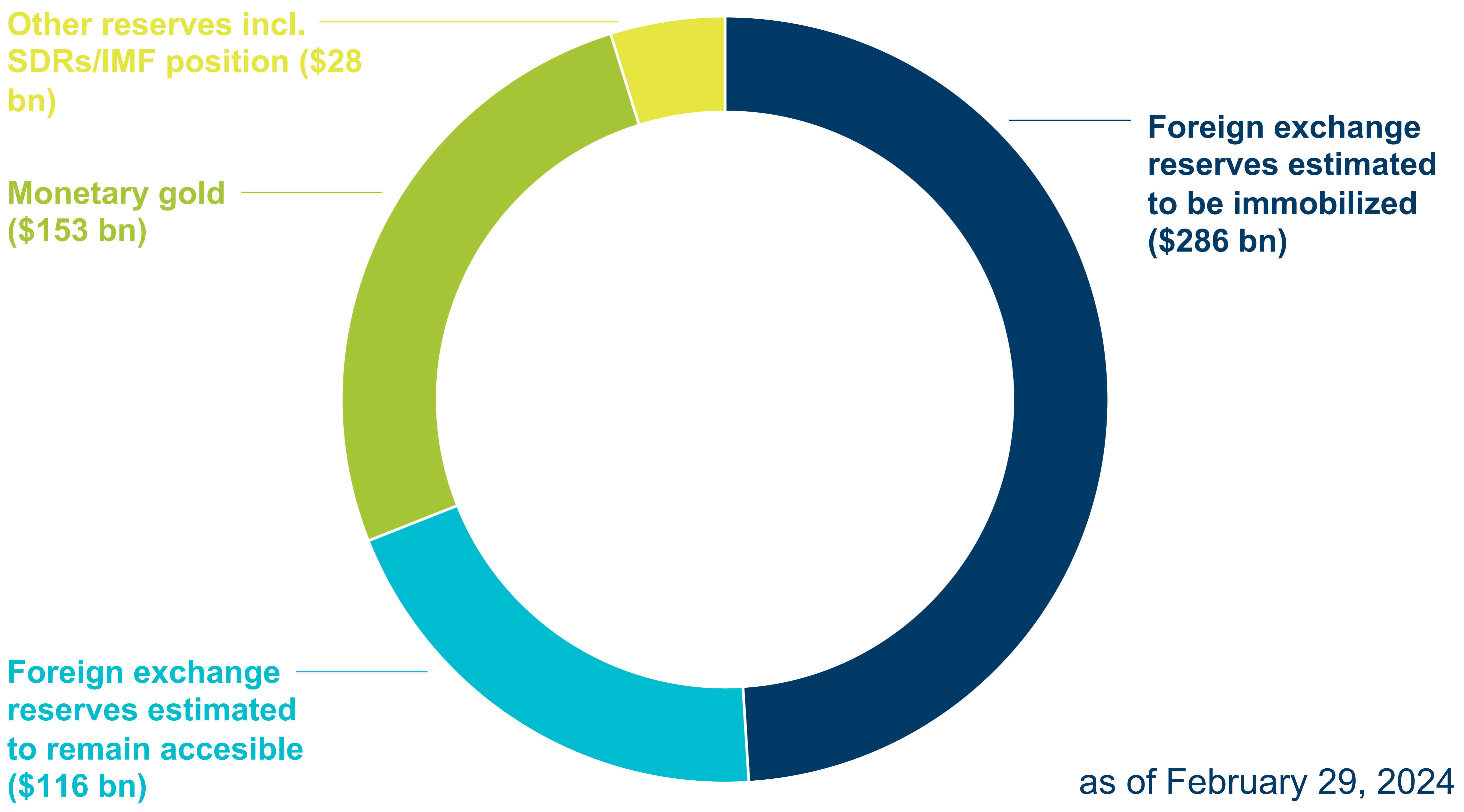
- Before the invasion, Russia held $634 billion in international reserves, part of what is described as *“Fortress Russia”.*
- We estimate that around $286 billion are currently immobilized due to international sanctions on CBR and NWF.
- This leaves Russia with access to $153 billion in monetary gold and roughly $118 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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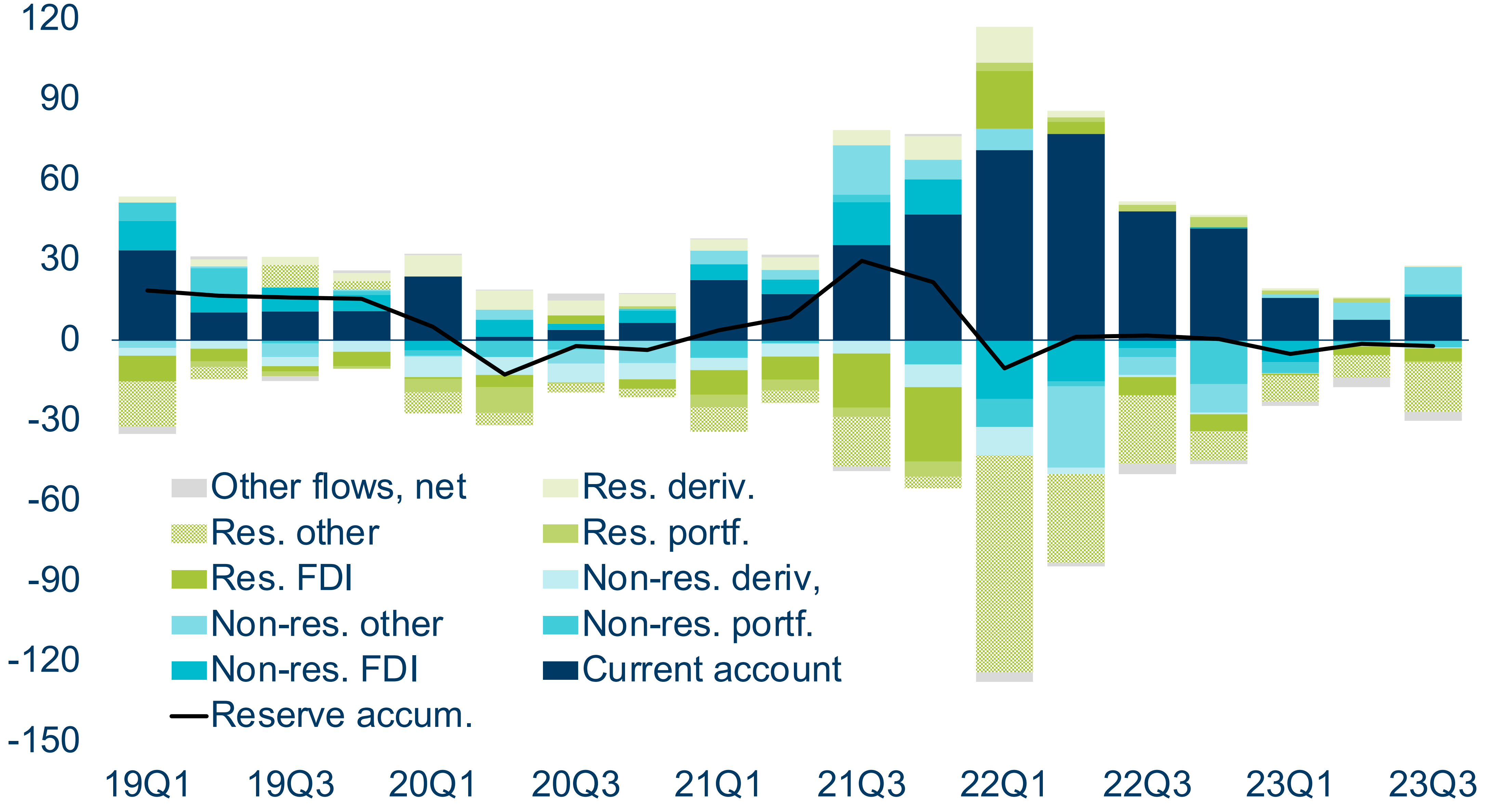
Significant accumulation of new foreign assets in 2022-23.

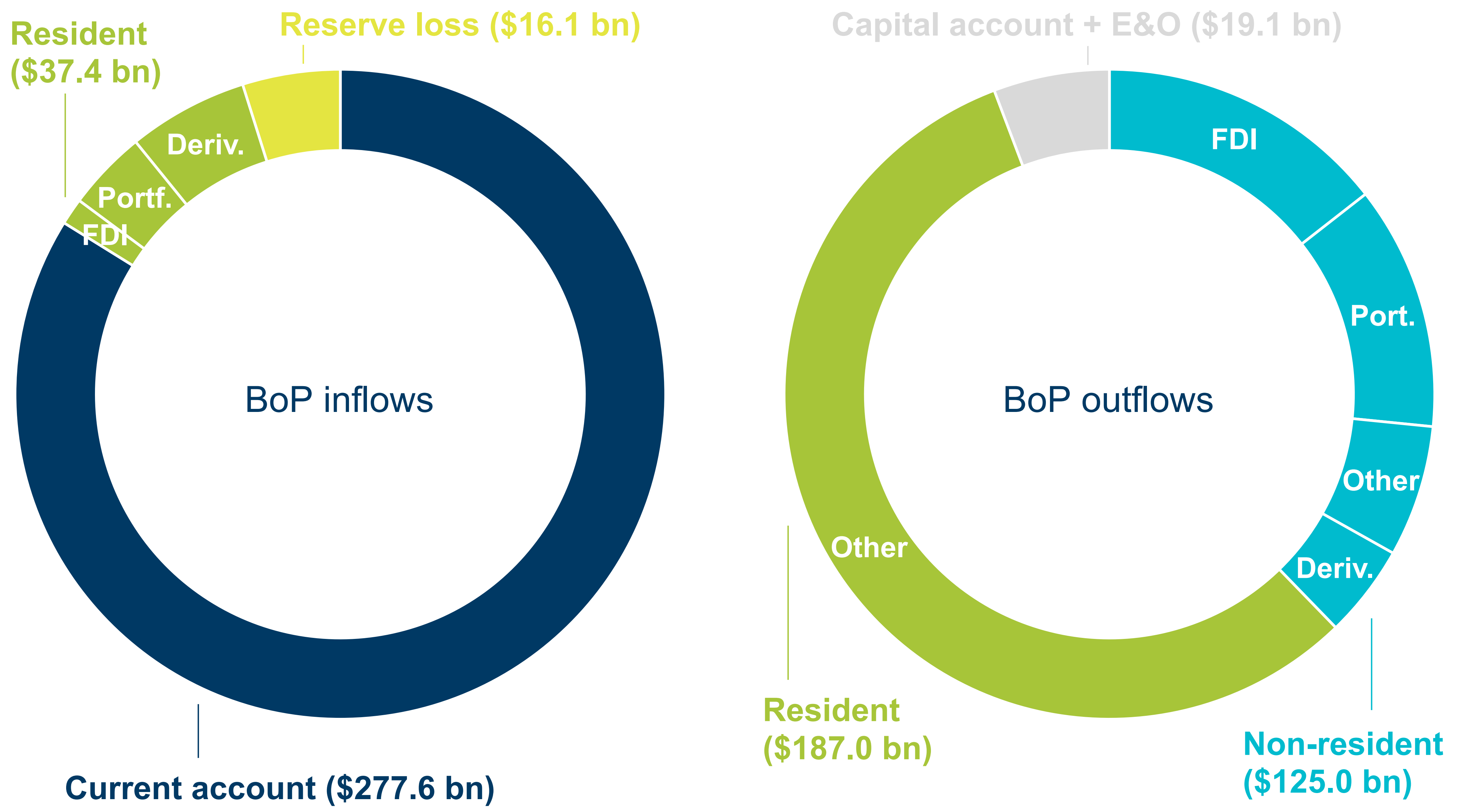
- It is time to focus attention on foreign assets that Russia has been able to accumulate due to favorable BoP dynamics.
- Non-resident capital outflows partially ate up the large current account surplus and resident inflows in Q1 2022-Q3 2023.
- But Russian banks and corporates were able to acquire $187 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

2022Q1-2023Q3 balance of payments flows, in U.S. dollar billion

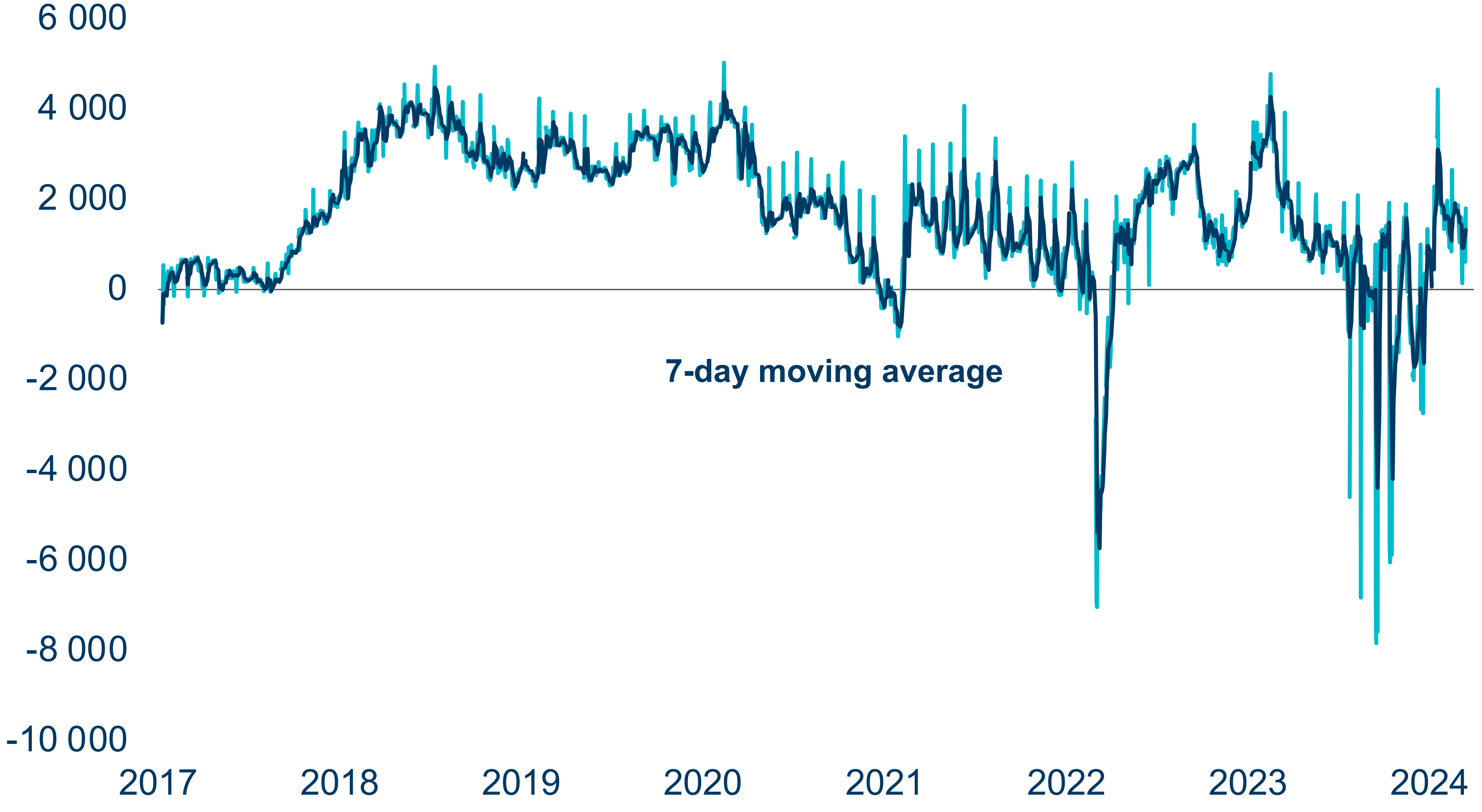


Source: Bank of Russia, KSE Institute

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

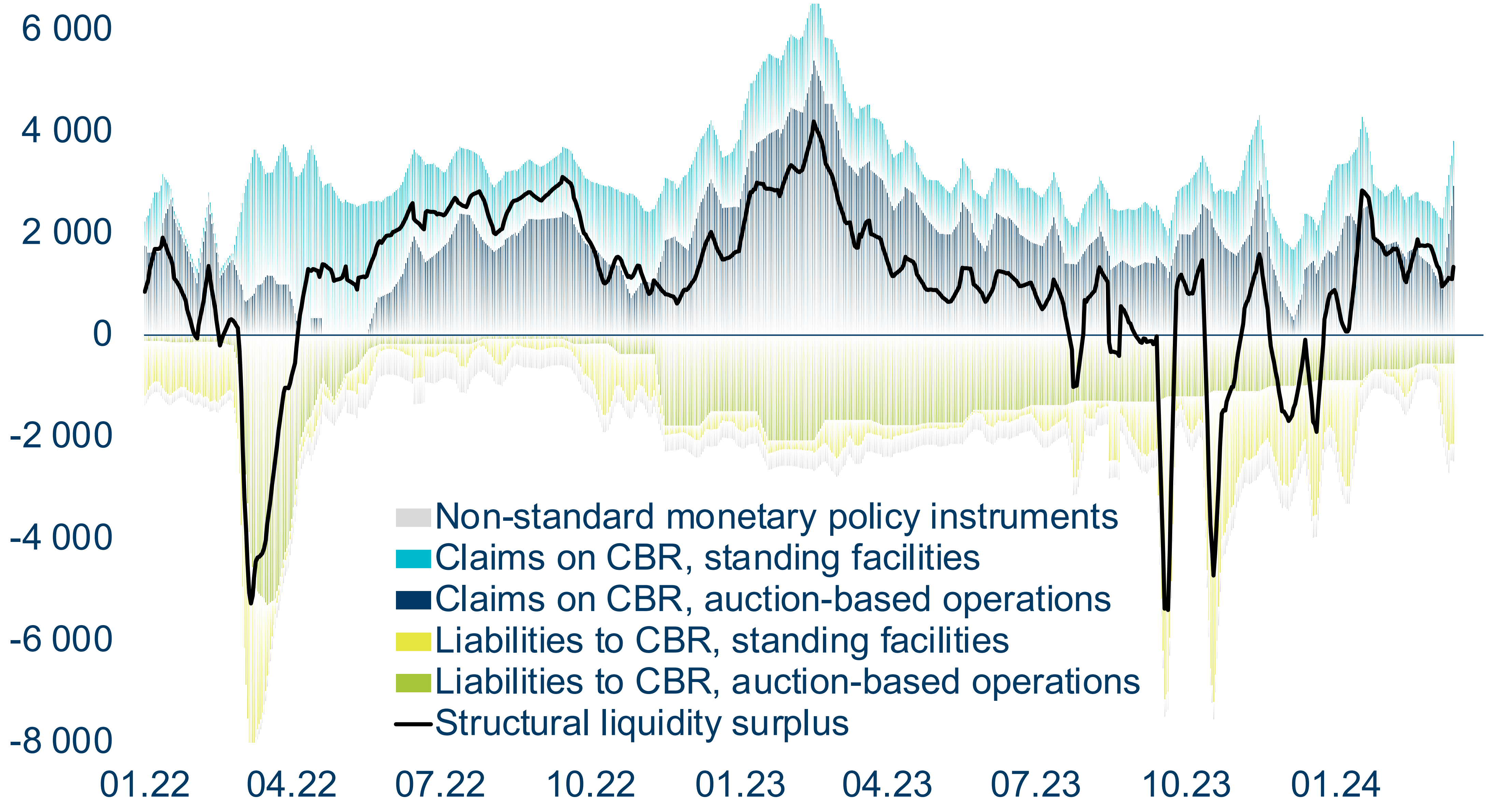
- Liquidity conditions recovered quickly after the initial shock from the full-scale war and imposition of sanctions.
- A closer look at the composition of the structural liquidity surplus points to some stress in the interbank market.
- The data clearly shows the effects of the CBR's monetary tightening 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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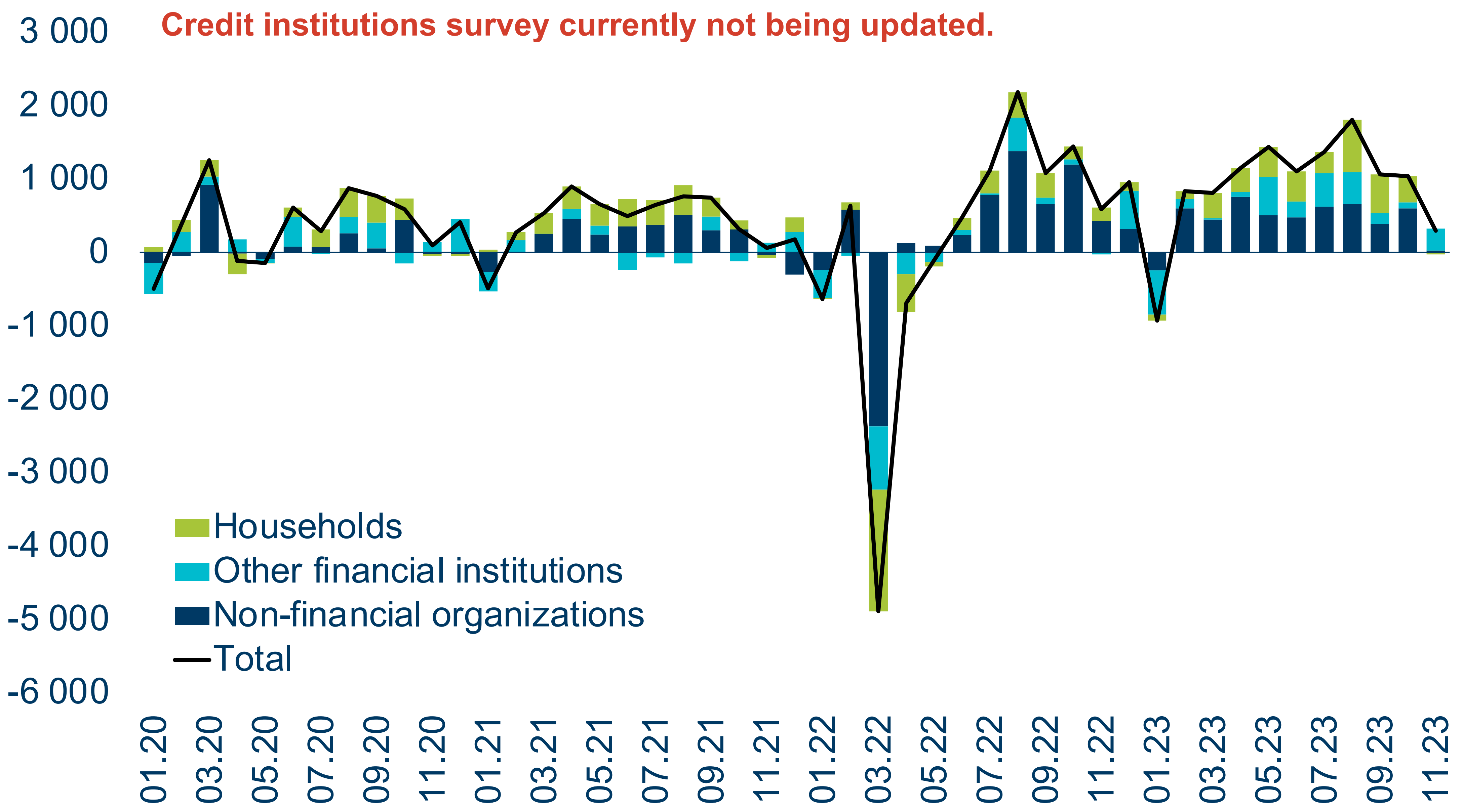
Private sector credit growth robust for the moment.

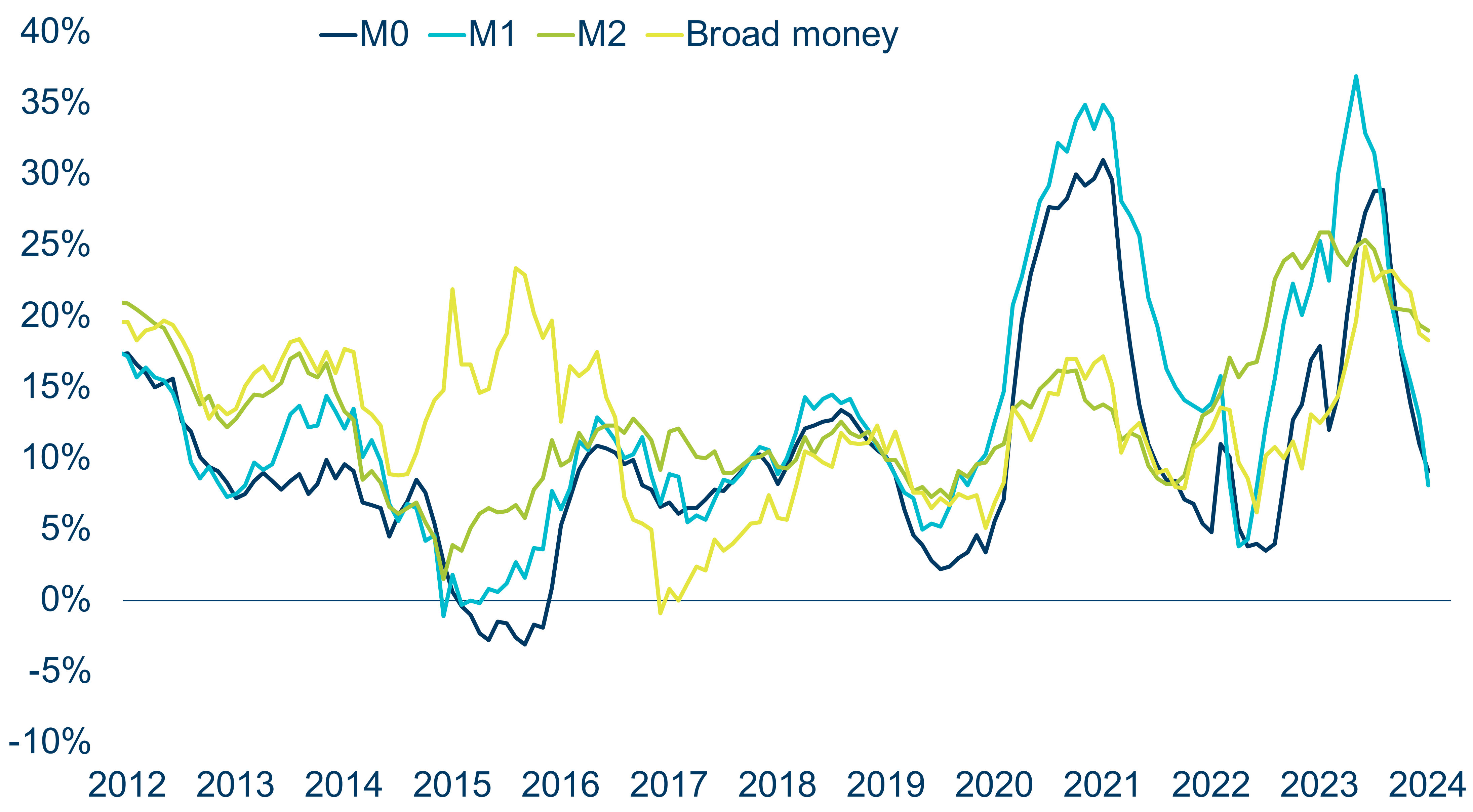
- Due to the provision of sufficient liquidity by the CBR, banks have been able to provide the private sector with credit.
- The CBR was able to simultaneously address monetary and financial stability in 2022 due to the supportive environment.
- With FX inflows down and the ruble under pressure, conflicts 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: robust growth in 2023-24 due to large fiscal stimulus from military spending

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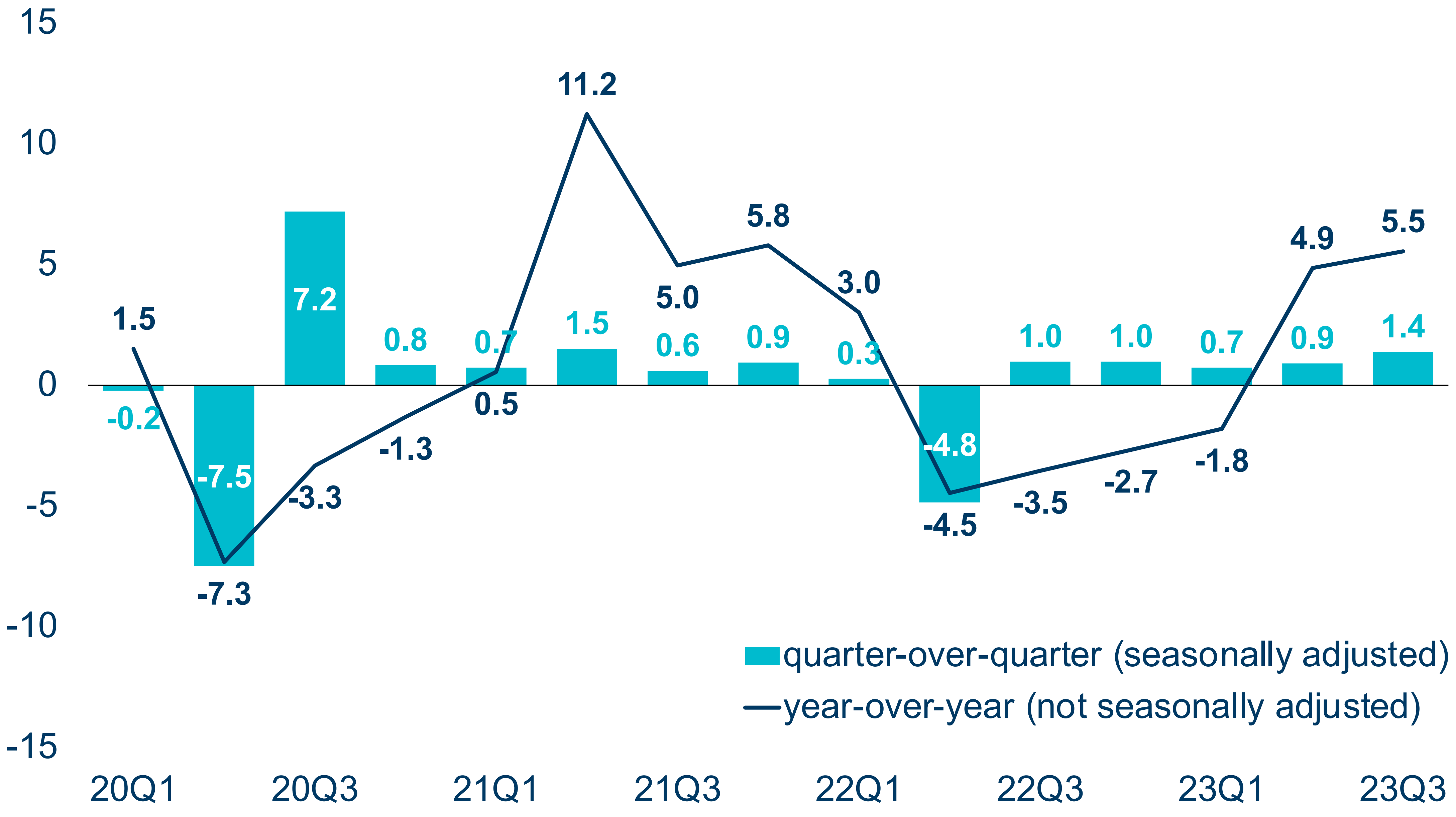
Russia’s economy grew at 3.6% in 2023 on the back of war spending.

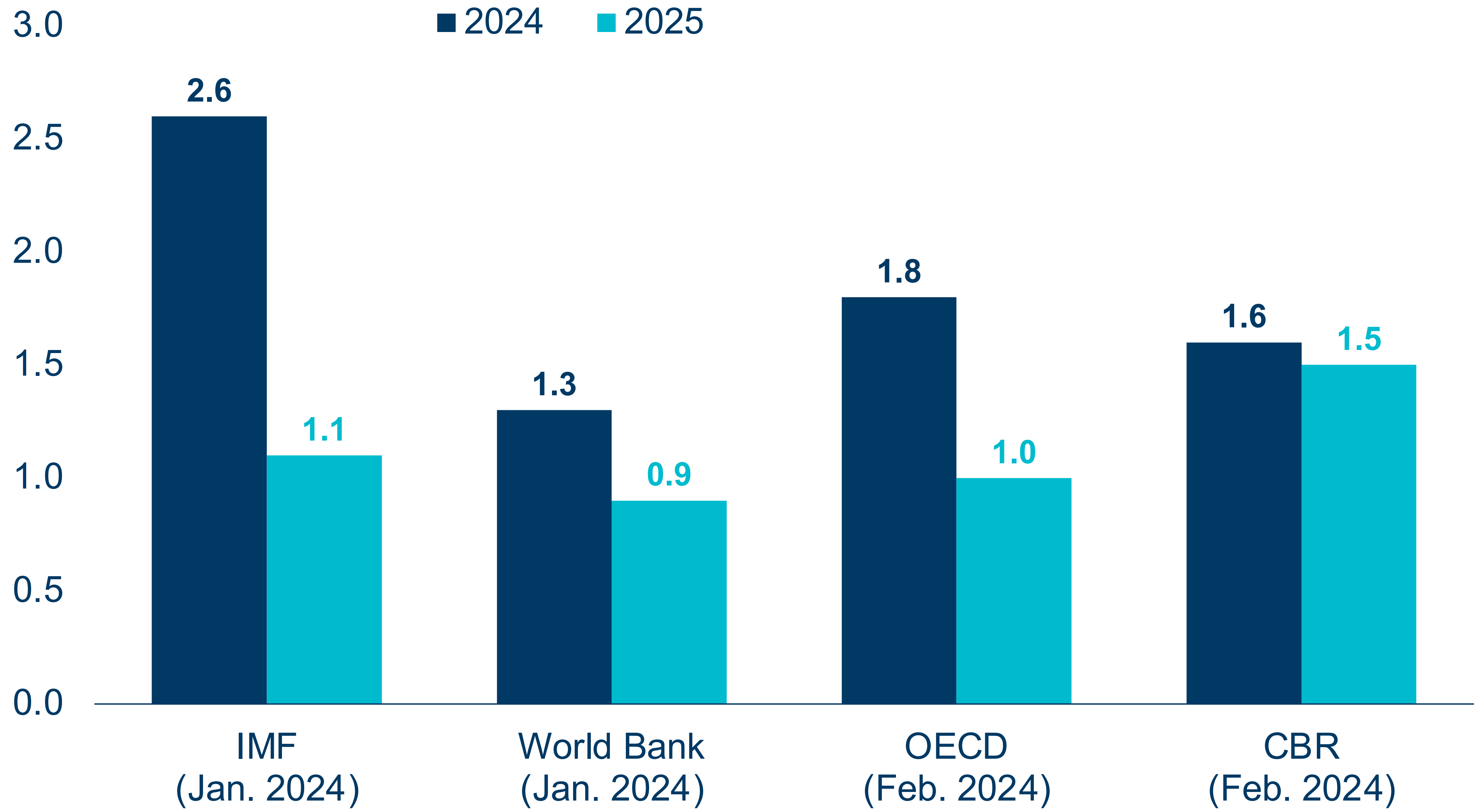
- Rosstat revised 2022 real GDP growth up to -1.2% (from -2.1%) and estimates 2023 growth at 3.6%.
- Key factors: strong fiscal stimulus from high defense spending and robust private sector credit growth.
- Quarterly numbers have not been published for Q4 2023 and not been revised for the previous year.

Quarterly real GDP dynamics, in %



Source: Rosstat, KSE Institute

2024-25 forecasts for Russian real GDP, in % year-over-year



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

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- March 2023
- February 2023
- December 2022